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Proposed statement on auditing standards : letters to underwriters in conjunction with filings under the securities act of 1933 and letters issued to a requesting party in conjunction with other financing transactions; Letters to underwriters in conjunction with filings under the securities act of 1933 and letters issued to a requesting party in conjunction with other financing transactions; Exposure draft (American Institute of Certified Public Accountants), 1991, May 10

American Institute of Certified Public Accountants. Auditing Standards Board

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EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS

**LETTERS TO UNDERWRITERS IN CONJUNCTION
WITH FILINGS UNDER THE SECURITIES ACT OF 1933
AND LETTERS ISSUED TO A REQUESTING PARTY IN
CONJUNCTION WITH OTHER FINANCING
TRANSACTIONS**

MAY 10, 1991

**Prepared by the AICPA Auditing Standards Board
For comment from persons interested in auditing and reporting**

**Comments should be received by July 10, 1991, and addressed to
Jane M. Mancino, Technical Manager, AICPA Auditing Standards Division, File 2312
AICPA, 1211 Avenue of the Americas, New York, N.Y. 10036-8775**

SUMMARY

Why Issued

The service of accountants providing letters to underwriters developed following enactment of the Securities Act of 1933 (the "Act"). Section 11 of the Act provides that underwriters, among others, could be liable if any part of a registration statement contains material omissions or misstatements. The Act also provides for an affirmative defense for underwriters if it can be demonstrated that, after a reasonable investigation, the underwriter had reasonable grounds to believe that there were no material omissions or misstatements. Consequently, underwriters request accountants to assist them in developing a record of reasonable investigation, called "due diligence," to help establish their affirmative defense under section 11 of the Act. The accountants' letters to underwriters, also known as "comfort letters," are one of a number of elements developed to establish that an underwriter has conducted this reasonable investigation. Other elements, not necessarily involving accountants, include (1) the due diligence meetings, which afford members of the underwriting group an opportunity to hear management's presentation about an offering and to question management, (2) various meetings held by the managing underwriter and its representatives with management to develop the disclosure document, (3) field inspections, and (4) inspection of the issuer's books and records. Thus, obtaining the accountants' letter is but one of an array of activities that underwriters undertake to respond to the liability imposed on them under section 11 of the Act.

The guidance in paragraphs 2–48 provides for this traditional service. Included is the present practice of providing negative assurance about the presentation of unaudited financial data in accordance with generally accepted accounting principles. The accountant provides that negative assurance as long as the underwriter specifies the procedures the accountant is to perform for the underwriter's purposes.

Furthermore, the guidance in Statement on Auditing Standards (SAS) No. 49, *Letters for Underwriters*, concerning an accountant's comments in a comfort letter on a financial forecast, pro forma financial information, and other assertions has been revised to be consistent with related guidance (that is, Statements on Standards for Attestation Engagements *Attestation Standards, Financial Forecasts and Projections*, and *Reporting on Pro Forma Financial Information*) issued subsequent to SAS No. 49.

Since SAS No. 49 was issued, accountants have been requested to issue comfort letters to parties other than underwriters and in connection with securities offerings other than those registered under the Act. This proposed Statement provides guidance on those parties to whom accountants may provide comfort letters. It also provides guidance on the type of letters the accountant may provide for parties who do not have liability under section 11 of the Act. Under this service, the accountant may perform requested procedures and report on the findings obtained but would not provide negative assurance based on such procedures.

What It Does

Letters to Underwriters

This proposed Statement —

- States that the accountant may provide comfort letters only to those parties with a due diligence defense under section 11 of the Act.
- Prohibits the accountant from providing any additional letters to the underwriter or others in connection with the same transaction in which the accountant comments on items for which comment is otherwise precluded by this document.
- Provides guidance on the effect on the comfort letter of an accountant's report on the audited financial statements included in the registration statement that contains an explanatory paragraph.
- Revises the guidance and related example letters to conform with the Statements on Standards for Attestation Engagements *Attestation Standards, Financial Forecasts and Projections*, and *Reporting on Pro Forma Financial Information*, which were issued subsequent to SAS No. 49. Two of the most significant changes are the following:
 - This Statement removes the prohibition against commenting in a comfort letter on a financial forecast and provides guidance on how the accountant may comment in a comfort letter on a financial forecast.

- This Statement permits the accountant to give negative assurance on compliance as to form with certain specified disclosure requirements of Regulation S-K as long as specific criteria are met.

Letters to a Requesting Party in Conjunction With Financing Transaction

This proposed Statement—

- Limits statements by an accountant to procedures performed and findings obtained about (1) unaudited condensed interim financial information, (2) capsule financial information, (3) pro forma financial information, (4) financial forecasts, and (5) subsequent changes or decreases.
- Prohibits the accountant from providing negative assurance based on agreed-upon procedures applied to the foregoing items.
- In these situations, the accountant may perform a SAS No. 36 review on interim financial information and provide negative assurance thereon, if the client so requests.

Letters in Connection With Matters Relating to Solvency

This proposed Statement—

- Incorporates the guidance from the February 1988 interpretation of Statement on Standards for Attestation Engagements *Attestation Standards* on responding to requests for reports on matters relating to solvency.
- Revises the example letter to conform with the guidance in “Letters to a Requesting Party in Conjunction With Financing Transactions.”

Appendix

The differences between SAS No. 49 and the proposed revision are discussed in greater detail in the appendix.

How It Affects Existing Standards

This proposed Statement—

- Will supersede SAS No. 49.
- Amends SAS No. 35, *Special Reports—Applying Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement*, to note that if the accountant is requested to perform an agreed-upon procedures engagement in connection with a financing transaction, as defined, he or she must follow the guidance in the SAS No. 49 revision.
- Amends the Statements on Standards for Attestation Engagements *Attestation Standards* and *Financial Forecasts and Projections* to note that the practitioner must follow the guidance in the SAS No. 49 revision when requested to perform agreed-upon procedures on an assertion or on a forecast and report on such procedures in (1) a letter to an underwriter in connection with a filing under the Act, and (2) a letter to a party who does not have liability under section 11 of the Act in connection with a financing transaction.
- Deletes paragraph 20 of AICPA *Professional Standards*, AU section 504, “Association With Financial Statements,” because the guidance in paragraphs 49 through 61 of this proposed Statement would cover requests from those parties previously covered by AU section 504, paragraph 20.

This exposure draft has been sent to—

- *Practice offices of CPA firms.*
 - *Members of AICPA Council and technical committees.*
 - *State society and chapter presidents, directors, and committee chairpersons.*
 - *Organizations concerned with regulatory, supervisory, or other public disclosure of financial activities.*
 - *Persons who have requested copies.*
-

May 10, 1991

Accompanying this letter is an exposure draft, approved by the Auditing Standards Board, of a proposed statement on auditing standards titled Letters to Underwriters in Conjunction With Filings Under the Securities Act of 1933 and Letters Issued to a Requesting Party in Conjunction With Other Financing Transactions. This proposed Statement provides guidance to accountants in performing engagements to provide (1) letters to underwriters in conjunction with filings under the Securities Act of 1933, (2) letters to a requesting party in conjunction with other financing transactions, and (3) letters in connection with matters relating to solvency. A summary of the proposed Statement also accompanies this letter. The appendix describes the differences between SAS No. 49, Letters for Underwriters, and the proposed revision in greater detail.

Comments or suggestions on any aspect of this exposure draft will be appreciated. To facilitate consideration of responses by the Auditing Standards Board, comments should refer to specific paragraphs and include supporting reasons for each suggestion or comment.

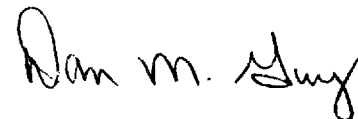
In developing guidance, the Auditing Standards Board considers the relationship between the cost imposed and the benefits reasonably expected to be derived. Thus, the Board would particularly appreciate comments on those matters.

Written comments on the exposure draft will become part of the public record of the AICPA Auditing Standards Division and will be available for public inspection at the offices of the AICPA after August 9, 1991, for one year. Responses should be sent to the Auditing Standards Division, File 2312, in time to be received by July 10, 1991.

Sincerely,



Donald L. Neebes
Chairman
Auditing Standards Board



Dan M. Guy
Vice President
Auditing Standards Division

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PROPOSED STATEMENT ON AUDITING STANDARDS

LETTERS TO UNDERWRITERS IN CONJUNCTION WITH FILINGS UNDER THE SECURITIES ACT OF 1933 AND LETTERS ISSUED TO A REQUESTING PARTY IN CONJUNCTION WITH OTHER FINANCING TRANSACTIONS

INTRODUCTION

1. This Statement¹ provides guidance² to accountants for performing and reporting on the results of engagements to issue—

- a. Letters to underwriters (commonly referred to as “comfort letters”), or to other parties with liability under section 11 of the Securities Act of 1933 (the “Act”), in connection with financial statements and financial statement schedules contained in registration statements filed with the Securities and Exchange Commission (SEC) under the Act (see paragraphs 2–48).
- b. Letters to a requesting party in conjunction with other financing transactions. For purposes of this Statement, a financing transaction includes debt or equity offerings or exchanges, guarantees of debt or other securities, and cash merger transactions (see paragraphs 49–61).³
- c. Letters in connection with matters relating to solvency (see paragraphs 62–65).

¹This proposed Statement also amends Statement on Auditing Standards (SAS) No. 35, *Special Reports—Applying Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement* (AICPA, *Professional Standards*, vol. 1, AU sec. 622) to add footnote 4, as follows, to paragraph 1:

⁴When an accountant is requested, by a party who does not have section 11 liability under the Securities Act of 1933, to perform, in connection with a financing transaction, agreed-upon procedures on historical financial information, the accountant should follow the guidance in SAS No. XX, *Letters to Underwriters in Conjunction With Filings Under the Securities Act of 1933 and Letters Issued to a Requesting Party in Conjunction With Other Financing Transactions*, paragraphs 49–61.

Accountants, when issuing a letter under the guidance provided in SAS No. XX, may not issue any additional letters or reports, under this standard or any other standard, to the underwriter or other requesting party in connection with the same transaction in which the accountants comment on items for which commenting is otherwise precluded by SAS No. XX.

This proposed Statement also amends Statement on Standards for Attestation Engagements *Financial Forecasts and Projections* (AICPA, *Professional Standards*, vol. 1, AT sec. 200) to add footnote 27, as follows, to paragraph 49 and rennumbers the subsequent footnote:

²⁷Accountants should follow the guidance in SAS No. XX, *Letters to Underwriters in Conjunction With Filings Under the Securities Act of 1933 and Letters Issued to a Requesting Party in Conjunction With Other Financing Transactions*, when requested to perform agreed-upon procedures on a forecast and report thereon in the following:

1. A letter to an underwriter in connection with a filing under the Securities Act of 1933 (see paragraph 21i)
2. A letter to a party who does not have section 11 liability under the Securities Act of 1933, in connection with a financing transaction (see paragraphs 49–61)

Accountants, when issuing a letter under the guidance provided in SAS No. XX, may not issue any additional letters or reports, under this standard or any other standard, to the underwriter or other requesting party in connection with the same transaction in which the accountants comment on items for which commenting is otherwise precluded by SAS No. XX.

This proposed Statement also amends Statement on Standards for Attestation Engagements *Attestation Standards* (AICPA, *Professional Standards*, vol. 1, AT sec. 100) to add footnote 8, as follows, to paragraph 59 and rennumbers the subsequent footnotes:

⁸Accountants should follow the guidance in SAS No. XX, *Letters to Underwriters in Conjunction With Filings Under the Securities Act of 1933 and Letters Issued to a Requesting Party in Conjunction With Other Financing Transactions*, when requested to perform agreed-upon procedures on an assertion and report thereon in the following:

1. A letter to an underwriter in connection with a filing under the Securities Act of 1933
2. A letter to a party who does not have section 11 liability under the Securities Act of 1933, in connection with a financing transaction (see paragraphs 49–61)

Accountants, when issuing a letter under the guidance provided in SAS No. XX, may not issue any additional letters or reports, under this standard or any other standard, to the underwriter or other requesting party in connection with the same transaction in which the accountants comment on items for which commenting is otherwise precluded by SAS No. XX.

This proposed Statement also amends SAS No. 26, *Association With Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 504) to delete paragraph 20, since that guidance will be superseded by the guidance in SAS No. XX.

²When issuing a letter in connection with a transaction under the guidance provided by this Statement, accountants may not issue, in connection with the same transaction, any additional letters or reports to the underwriter or other requesting party in which the accountants comment on items for which commenting is precluded by this Statement. For example, accountants may not issue an attest report that addresses backlog (see paragraph 41).

³For purposes of a due diligence review in connection with a proposed merger or acquisition, accountants should follow the guidance in SAS No. 35.

LETTERS TO UNDERWRITERS

2. This section (paragraphs 2–48) only applies to letters to an underwriter⁴ in connection with a registration statement involving a securities offering for which the underwriter has a statutory due diligence defense under section 11 of the Act. In situations in which requesting parties do not have section 11 liability, the guidance in paragraphs 49–61 should be followed.

3. The services of independent accountants include audits of financial statements and financial statement schedules contained in registration statements filed with the SEC under the Act. In connection with this type of service, accountants are often called upon to confer with clients, underwriters, and their respective counsel concerning the accounting and auditing requirements of the Act and the SEC and to perform other services. One of these other services is the issuance of letters for underwriters, which are generally concerned with the subjects described in paragraph 8.

4. Much of the uncertainty, and consequent risk of misunderstanding, with regard to the nature and scope of comfort letters has arisen from a lack of recognition of the necessarily limited nature of the comments that accountants can properly make with respect to financial information, in a registration statement, that has not been audited in accordance with generally accepted auditing standards and, accordingly, is not covered by their opinion. In requesting comfort letters, underwriters are generally seeking assistance on matters of importance to them. They wish to perform a “reasonable investigation” of financial and accounting data not “expertized” (that is, covered by a report of independent accountants, who consent to be named as experts, based on an audit performed in accordance with generally accepted auditing standards) as a defense against possible claims under section 11 of the Act.⁵ What constitutes a reasonable investigation of unaudited financial information sufficient to satisfy an underwriter’s purposes has never been authoritatively established. Consequently, only the underwriter can determine what is sufficient for his or her purposes. Accountants will normally be willing to assist the underwriter, but the assistance accountants can provide by way of comfort letters is subject to limitations. One limitation is that an independent accountant can properly comment in his or her professional capacity only on matters to which his or her professional expertise is substantially relevant. Another limitation is that procedures short of an audit, such as those contemplated in a comfort letter, provide the accountant with a basis for expressing, at the most, negative assurance.⁶ Such limited procedures may bring to the accountant’s attention significant matters affecting the financial information, but they do not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit. Accordingly, there is necessarily a risk that the accountant may have provided negative assurance of the absence of conditions or matters that may prove to have existed.

5. Several matters are addressed in this section. First, this Statement addresses whether, in a number of areas involving professional standards, it is proper for independent accountants, acting in their professional capacity, to comment in a comfort letter on specified matters and, if so, the form such a comment should take. Second, practical suggestions are offered on which form of comfort letter is suitable in a given circumstance, procedural matters, the dating of letters, and what steps may be taken when information that may require special mention in a letter comes to the accountants’ attention.⁷ Third, ways of reducing or avoiding the uncertainties, described in the preceding paragraph, regarding the nature and extent of accountants’ responsibilities in connection with a comfort letter are suggested. With regard to this and other points not involving professional standards, when the recommendations are intended to reduce risks of misunderstanding, accountants who have been requested to follow a course other than what has been recommended would do well to consult their counsel.

⁴The term *underwriter* is defined in section 2 of the Act as “any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors’ or sellers’ commission. As used in this paragraph, the term *issuer* shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect control with the issuer.”

⁵See SAS No. 37, *Filings Under Federal Securities Statutes* (AICPA, *Professional Standards*, vol. 1, AU sec. 711), for a discussion of certain responsibilities of accountants that result from the inclusion of their reports in registration statements.

⁶Negative assurance consists of a statement by accountants that, as a result of specified procedures, nothing came to their attention that caused them to believe that specified matters do not meet a specified standard (for example, that nothing came to their attention that caused them to believe that unaudited financial statements or unaudited condensed financial statements are not in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited financial statements).

⁷It is important to note that although the illustrations in this Statement describe procedures that are frequently followed by accountants as a basis for their comments in comment letters, this Statement does not prescribe such procedures.

6. Comfort letters are not required under the Act, and copies are not filed with the SEC. It is nonetheless a common condition of an underwriting agreement in connection with the offering for sale of securities registered with the SEC under the Act that the accountants are to furnish a comfort letter. Some underwriters do not make the receipt of a comfort letter a condition of the underwriting agreement but nevertheless ask for such a letter.⁸

7. The accountants should suggest to the underwriter that they meet together with the client to discuss the procedures to be followed in connection with a comfort letter; during the meeting, the accountants may describe procedures that are frequently followed (see examples A–N, paragraphs 66–80). Because of the accountants' knowledge of the client, such a meeting may substantially assist the underwriter in reaching his or her decision about procedures to be followed by the accountants. However, any discussion of procedures should be accompanied by a clear statement that the accountants cannot furnish any assurance regarding the sufficiency of the procedures for the underwriter's purposes. The appropriate way of expressing this is shown in paragraph 4 of example A.

8. Comfort letters will generally refer to one or more of the following subjects:

- a. The independence of the accountants
- b. Whether the audited financial statements and financial statement schedules included in the registration statement comply as to form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations⁹
- c. Unaudited financial statements, condensed interim financial information, capsule financial information, pro forma financial information, or financial forecasts included in the registration statement
- d. Changes in selected financial statement items during a period subsequent to the date and period of the latest financial statements included in the registration statement
- e. Whether certain non-financial statement information included in the registration statement complies as to form in all material respects with Regulation S-K¹⁰ (see paragraph 43)
- f. Tables, statistics, and other financial information included in the registration statement

These matters are discussed in greater detail later in the Statement and are illustrated in the examples included at the end of this Statement. Matters to be dealt with in a particular letter are usually limited to those specified in the underwriting agreement.

9. Because the underwriter will expect the accountants to furnish a comfort letter of a scope to be specified in the underwriting agreement, a draft of that agreement should be furnished to the accountants so that the latter can indicate whether they will be able to furnish a letter in an acceptable form. It is a desirable practice for the accountants, promptly after they have received the draft of the agreement (or have been informed that a letter covering specified matters, although not a condition of the agreement, will nonetheless be requested), to prepare a draft of the form of the letter they expect to furnish. To the extent possible, the draft should deal with all matters to be covered in the final letter and should use exactly the same terms as those used in the final letter (subject, of course, to the understanding that the comments in the final letter cannot be determined until the procedures underlying it have been performed). The draft letter should be identified as a draft to avoid giving the impression that the procedures described therein have been performed. This practice of furnishing a draft letter at an early point permits the accountants to make clear to the client and the underwriter what they may expect the accountants to furnish and gives the client and the underwriter an opportunity to change the proposed underwriting agreement if they so desire. Thus furnished with a draft letter, the underwriter is afforded the opportunity to discuss further with the accountants the procedures that the accountants have indicated they expect to follow and to request any additional procedures that the underwriter may desire. If the additional procedures pertain to matters relevant to the accountants' professional competence, the accountants would ordinarily be willing to perform them, and it is desirable for them to furnish the underwriter with

⁸Except when the context otherwise requires, the word *underwriter*, as used in this Statement, refers to the managing, or lead, underwriter, who typically negotiates the underwriting agreement for a group of underwriters whose exact composition is not determined until shortly before a registration statement becomes effective. In competitive bidding situations in which legal counsel for the underwriters acts as the underwriters' representative prior to the opening and acceptance of the bid, the accountants should carry out the discussions and other communications contemplated by this Statement with the legal counsel until the underwriter is selected.

⁹Regulation S-X, "Form and Content of and Requirements for Financial Statements, Securities Act of 1933, Securities Exchange Act of 1934, Public Utility Holding Company Act of 1935, Investment Company Act of 1940, and Energy Policy and Conservation Act of 1975."

¹⁰Regulation S-K, "Standard Instructions for Filing Forms Under Securities Act of 1933, Securities Exchange Act of 1934 and Energy Policy and Conservation Act of 1975."

an appropriately revised draft letter. The accountants may reasonably assume that the underwriter, by indicating his or her acceptance of the draft comfort letter and, subsequently, by accepting the letter in final form, considers the procedures described sufficient for his or her purposes. It is important, therefore, that the procedures to be followed by the accountants be clearly set out in the comfort letter, in both draft and final form, so that there will be no misunderstanding about the basis on which the accountants' comments have been made and so that the underwriter can decide whether the procedures performed are sufficient for his or her purposes. For reasons explained in paragraph 4, statements or implications that the accountants are carrying out such procedures as they consider necessary should be avoided, since this may lead to misunderstanding about the responsibility for the sufficiency of the procedures for the underwriter's purposes. The following is a suggested form of legend that may be placed on the draft letter for identification and explanation of its purposes and limitations.

This draft is furnished solely for the purpose of indicating the form of letter that we would expect to be able to furnish [name of underwriter] in response to their request, the matters expected to be covered in the letter, and the nature of the procedures that we would expect to carry out with respect to such matters. Based on our discussions with [name of underwriter], it is our understanding that the procedures outlined in this draft letter are those they wish us to follow.¹¹ Unless [name of underwriter] informs us otherwise, we shall assume that there are no additional procedures they wish us to follow. The text of the letter itself will depend, of course, on the results of the procedures, which we would not expect to complete until shortly before the letter is given and in no event before the cutoff date indicated therein.

10. Regulations under the Act permit companies, in certain circumstances, to register a designated amount of securities for continuous or delayed offerings during an extended period by filing one "shelf" registration statement. At the effective date of a shelf registration statement, the registrant may not have selected an underwriter (see footnote 8). A client or the legal counsel designated to represent the underwriting group might, however, ask the accountants to issue a comfort letter at the effective date of a shelf registration statement to expedite the due diligence activities of the underwriter when he or she is subsequently designated and to avoid later corrections of financial information included in an effective prospectus. However, as stated in paragraph 4, only the underwriter can determine the procedures that will be sufficient for his or her purposes. Under these circumstances, therefore, the accountants should not agree to furnish a comfort letter addressed to the client, legal counsel, or a nonspecific addressee such as "any or all underwriters to be selected." The accountants may agree to furnish the client or legal counsel for the underwriting group with a draft comfort letter describing the procedures that the accountants have performed and the comments the accountants are willing to express as a result of those procedures. The draft comfort letter should include a legend, such as the following, describing the letter's purpose and limitations:

This draft describes the procedures that we have performed and represents a letter we would be prepared to sign as of the effective date of the registration statement if the managing underwriter had been chosen at that date and requested such a letter. Based on our discussions with [name of client or legal counsel], the procedures set forth are similar to those that experience indicates underwriters often request in such circumstances. The text of the final letter will depend, of course, on whether the managing underwriter who is selected requests that other procedures be performed to meet his or her needs and whether the managing underwriter requests that any of the procedures be updated to the date of issuance of the signed letter.

A signed comfort letter may be issued to the underwriter selected for the portion of the issue then being offered when the underwriting agreement for an offering is signed and on each closing date.

Dating

11. The letter is ordinarily dated on or shortly before the effective date (that is, the date on which the registration statement becomes effective). On rare occasions, letters have been requested to be dated at or shortly before the filing date (that is, the date on which the registration statement is first filed with the SEC). The underwriting agreement ordinarily specifies the date, often referred to as the "cutoff date," to which the letter is to relate (for example, a date five days before the date of the letter). The letter should state that the inquiries and other procedures carried out in connection with the letter did not cover the period from the cutoff date to the date of the letter.

¹¹In the absence of any discussions with the underwriter, the accountants should outline in the draft letter those procedures specified in the underwriting agreement that they are willing to perform. In that event, the sentence to which this footnote refers should be revised as follows: "In the absence of any discussions with [name of underwriter], we have set out in this draft letter those procedures referred to in the draft underwriting agreement (of which we have been furnished a copy) that we are willing to follow."

12. An additional letter may also be dated at or shortly before the closing date (that is, the date on which the issuer or selling security holder delivers the securities to the underwriter in exchange for the proceeds of the offering). If more than one letter is requested, it will be necessary to carry out the specified procedures and inquiries as of the cutoff date for each letter. Although comments contained in an earlier letter may, on occasion, be incorporated by reference in a subsequent letter (see example C), any subsequent letter should relate only to information in the registration statement as most recently amended.

Addressee

13. The letter should not be addressed or given to any parties other than the client and the named underwriters¹² who have a due diligence defense under section 11 of the Act. A comfort letter may be addressed to another requesting party, other than a named underwriter, only when a law firm or attorney for the requesting party issues a written opinion to the accountants that states that such party has a due diligence defense under section 11 of the Act. The appropriate underwriter addressee is the underwriter who has negotiated the underwriting agreement with the client, and with whom the accountants will deal in discussions regarding the scope and sufficiency of the letter.

Introductory Paragraph

14. It is desirable to include an introductory paragraph similar to the following:

We have audited the [*identify the financial statements and financial statement schedules audited*] included [incorporated by reference] in the registration statement (no. 33-00000) on Form _____ filed by the company under the Securities Act of 1933 (the Act); our reports with respect thereto are also included [incorporated by reference] in that registration statement. The registration statement, as amended as of _____, is herein referred to as the registration statement.

Independence

15. It is customary for the underwriting agreement to provide for the accountants to make a statement in the letter concerning their independence. This may be done substantially as follows:

We are independent certified public accountants with respect to The Blank Company, Inc., within the meaning of the Act and the applicable published rules and regulations thereunder.

Regulation S-K requires disclosure in the prospectus and registration statement of interests of named experts (including independent accountants) in the registrant. Regulation S-X precludes an accountant who reports on financial statements in a registration statement from having interests of the type requiring disclosure in the prospectus or registration statement. Therefore, if an accountant makes a statement in a comfort letter that he or she is independent within the meaning of the Act and the applicable published rules and regulations thereunder, any additional comments on independence would be unnecessary. (See paragraph 36 regarding instances in which the accountant's client is not the registrant.)

Compliance With SEC Requirements

16. The accountants may be requested to express an opinion on whether the financial statements covered by their report comply as to form with the pertinent published accounting requirements of the SEC.¹³ This may be done substantially as follows:

In our opinion [*include the phrase "except as disclosed in the registration statement," if applicable*], the [*identify the financial statements and financial statement schedules audited*] audited by us and included or incorporated by reference in the registration statement comply as to form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations.¹⁴

¹²An example of an appropriate form of address for this purpose is "The Blank Company and XYZ & Company, as Representative of the Several Underwriters."

¹³The term *published* is used because accountants should not be expected to be familiar with, or express assurances on compliance with, informal positions of the SEC staff.

¹⁴Certain financial statements may be incorporated in a registration statement under the Act by reference to filings under the Securities Exchange Act of 1934 (the "1934 Act"). In those circumstances, the accountants may refer to whether the audited financial statements and financial statement schedules included or incorporated by reference in the registration statement comply as to form in all material respects with the applicable accounting requirements of the 1934 Act and the related published rules and regulations (see example B). However, the accountants should not refer to compliance with the provisions of the 1934 Act regarding internal accounting control. See the auditing interpretation "Compliance with the Foreign Corrupt Practices Act of 1977" (AICPA, *Professional Standards*, vol. 1, AU sec. 9642.10-13).

If there is a material departure from the pertinent published requirements, the departure should be disclosed in the letter.¹⁵ An appropriate manner of doing this is shown in example K.

17. Accountants may provide positive assurance on compliance as to form with requirements under published SEC rules and regulations only with respect to those rules and regulations applicable to the form and content of the financial statements and financial statement schedules that they have audited. Accountants are limited to providing negative assurance when the financial statements or financial statement schedules have not been audited. (For guidance on compliance as to form, see paragraph 22 regarding unaudited condensed interim financial information, and paragraph 43 regarding Regulation S-K items.)

Accountants' Reports

18. Underwriters occasionally request that the accountants repeat in the comfort letter their report on the audited financial statements included in the registration statement. Because of the special significance of the date of an accountant's report, the accountants should not repeat their opinion.¹⁶ Underwriters sometimes request negative assurance regarding the accountants' report. Because accountants have a statutory responsibility with respect to their opinion as of the effective date, and because the additional significance, if any, of negative assurance is unclear and such assurance may therefore give rise to misunderstanding, accountants should not give such negative assurance. Furthermore, the accountants should not give negative assurance with respect to financial statements and financial statement schedules that have been audited and are reported on in the registration statement by other accountants.

19. An underwriter may also request that the accountants comment in their comfort letter on (a) unaudited interim financial information required by item 302(a) of Regulation S-K, to which SAS No. 36 pertains, or (b) required supplementary information, to which SAS No. 52 pertains. SAS No. 36, *Review of Interim Financial Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 722), and SAS No. 52, *Required Supplementary Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 558), provide that the accountant should expand the standard report on the audited financial statements to refer to such information when the scope of his or her procedures with regard to the information was restricted or when the information appears not to be presented in conformity with generally accepted accounting principles or, for required supplementary information, applicable guidelines. Such expansions of the accountant's standard report in the registration statement would ordinarily be referred to in the opening paragraph of the comfort letter (see paragraph 34). Additional comments on such unaudited information are therefore unnecessary. However, if the underwriter requests that the accountants perform procedures with regard to such information in addition to those performed in connection with the audit as prescribed by SAS Nos. 36 and 52, the accountants may do so and report their findings.

20. The accountants may refer in the introductory paragraphs of the comfort letter to the fact that they have issued reports on —

- a. Condensed financial statements that are derived from audited financial statements (see SAS No. 42, *Reporting on Condensed Financial Statements and Selected Financial Data* [AICPA, *Professional Standards*, vol. 1, AU sec. 552]).
- b. Selected financial data (see SAS No. 42).
- c. A review of interim financial information (see SAS No. 36).
- d. An examination or a review of pro forma financial information (see Statement on Standards for Attestation Engagements *Reporting on Pro Forma Financial Information* [AICPA, *Professional Standards*, vol. 1, AT sec. 300]).
- e. An examination or a compilation of a financial forecast (see Statement on Standards for Attestation Engagements *Financial Forecasts and Projections* [AICPA, *Professional Standards*, vol. 1, AT sec. 200]).

¹⁵Departures from published SEC requirements that require mention in a comfort letter ordinarily do not affect fair presentation in conformity with generally accepted accounting principles; however, if they do, the accountants will, of course, mention these departures in expressing their opinion and in consenting to the use of their report in the registration statement. If departures from published SEC requirements that require mention in a comfort letter either are not disclosed in the registration statement or have not been agreed to by representatives of the SEC, the accountants should carefully consider whether a consent to the use of their report in the registration statement should be issued.

¹⁶See section 530, "Dating of the Independent Auditor's Report," of SAS No. 1, *Codification of Auditing Standards and Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec. 530.03-08).

Such a reference should be to the accountants' reports that were previously issued, and if the reports are not included in the registration statement, they may be attached to the comfort letter. In referring to previously issued reports, the accountants should not repeat their reports in the comfort letter or otherwise imply that they are reporting as of the date of the comfort letter or that they assume responsibility for the sufficiency of the procedures for the underwriter's purposes. However, for certain information on which they have reported, the accountants may agree to comment regarding compliance with published SEC requirements (see paragraphs 16 and 17).

Reporting on Information, Other Than Audited Financial Statements, Included in Registration Statements

In General

21. Comments included in the letter will often concern (a) unaudited condensed interim financial information included in the registration statement (see paragraphs 22–23),¹⁷ (b) capsule financial information (see paragraphs 24–26), (c) changes in capital stock and long-term debt and decreases in other specified financial statement items (see paragraphs 27–32), (d) pro forma financial information (see item *h* below), and (e) financial forecasts (see item *i* below). For commenting on these matters, the following guidance is important:

- a. Any statements by the accountants with respect to unaudited condensed interim financial information, capsule financial information, and subsequent changes or decreases should be limited to negative assurance. An appropriate manner of expressing the comments is shown in paragraph 5 of example A.
- b. As explained in paragraph 9, the agreed-upon procedures performed by the accountants should be set forth in the letter. Such procedures are generally described along the lines of paragraph 4 of example A.
- c. To avoid any misunderstanding about the responsibility for the sufficiency of the agreed-upon procedures for the underwriter's purposes, the accountants should not make any statements, or imply, that they have applied procedures that they have determined to be necessary or sufficient for the underwriter's purposes. In this respect, the underwriter may request the accountants to perform procedures similar to those in SAS No. 36, paragraph 6. However, for the accountants to include such procedures in their letter, the underwriter would have to provide criteria that are sufficiently specific that there is no implication that the responsibility for the sufficiency of the agreed-upon procedures has been assumed by the accountants. For example, if the underwriter requests the accountants to apply analytical procedures and specifies items of financial information to be reviewed and the materiality level for changes in those items that would necessitate further inquiry by the accountants, the accountants may refer to those procedures in their letter. Descriptions of procedures in the comfort letter should include descriptions of the criteria specified by the underwriter.
- d. Terms of uncertain meaning (such as *general review*, *limited review*, *check*, or *test*) should not be used in describing the work, unless the procedures comprehended by these terms are described in the comfort letter.
- e. The letter should specifically identify any unaudited condensed interim financial information and should state that the accountants have not audited the condensed interim financial information in accordance with generally accepted auditing standards and do not express an opinion concerning such information. An appropriate manner of making this clear is shown in paragraph 3 of example A (see also paragraph 23 of this Statement).
- f. The accountants should not give negative assurance with respect to unaudited condensed interim financial information, capsule financial information, or changes or decreases unless they have obtained knowledge of the client's internal control structure relating to the preparation of financial statements. An understanding of the client's practices in preparing its most recent annual financial statements provides a practical basis for the accountants' inquiries or procedures. Ordinarily, accountants obtain such an understanding in auditing the client's financial statements for one or more annual periods. However, if, for whatever reason, the accountants have not conducted such an audit, the need for an understanding of the client's internal control structure is not diminished, and the accountants should consider whether, under the particular circumstances, they can acquire sufficient knowledge of these matters to perform the inquiries and procedures requested by the underwriter.
- g. The procedures followed with respect to interim periods may not disclose changes in capital stock or long-term debt or decreases in the specified financial statement items, inconsistencies in the application

¹⁷The SEC requirements specify condensed financial statements. However, the guidance in paragraphs 21–23 also applies to complete financial statements. For purposes of this Statement, interim financial statements may be for a twelve-month period ending on a date other than the entity's normal year-end.

of generally accepted accounting principles, instances of noncompliance as to form with accounting requirements of the SEC, or other matters about which negative assurance is requested. An appropriate manner of making this clear is shown in the last three sentences of paragraph 4 of example A.

- h. The accountants should not give negative assurance on the application of pro forma adjustments to historical financial statements, the compilation of pro forma financial information, whether the pro forma financial information complies as to form with published SEC rules and regulations or perform other agreed-upon procedures unless (1) they have performed an audit of the historical financial statements of the entity (or, in the case of business combinations, of a significant constituent part of the combined entity) for the period presented or, in the case of interim periods, for the latest fiscal period that includes or precedes the interim period or (2) they have otherwise obtained knowledge of the entity's internal control structure as provided for in item *f* above (see example D). The accountants should comply with the relevant guidance on reporting the results of agreed-upon procedures in Statement on Standards for Attestation Engagements *Attestation Standards* (AICPA, *Professional Standards*, vol. 1, AT sec. 100), paragraphs 59–70.
- i. When historical financial statements provide a basis for one or more significant assumptions for a forecast, the accountants should not perform agreed-upon procedures on a financial forecast unless they have (1) performed an audit of such historical financial statements of the entity or (2) otherwise obtained knowledge of the entity's internal control structure as provided for in item *f* above. For accountants to comment on a forecast, they should perform procedures prescribed in Statement on Standards for Attestation Engagements *Financial Forecasts and Projections*, appendix B, for reporting on compilation of a forecast. Having performed these procedures, they should follow the guidance in paragraphs 16–18 of *Financial Forecasts and Projections* regarding reports on compilations of prospective financial information and should attach their report thereon to the comfort letter.

If the accountants are requested to perform additional procedures, they may comment thereon in the comfort letter. Accountants should refer to the guidance on reporting on the results of agreed-upon procedures in paragraphs 54–57 of *Financial Forecasts and Projections* (see example E).

Accountants may not provide negative assurance with respect to compliance of the forecast with Rule II-03 of Regulation S-X unless they have performed an examination of the forecast in accordance with *Financial Forecasts and Projections*.

Unaudited Condensed Interim Financial Information

22. Comments in the comfort letter concerning the unaudited condensed interim financial information appearing in the registration statement should always be made in the form of negative assurance. Frequently, such comments relate to (a) conformity with generally accepted accounting principles, (b) substantial consistency with the audited financial statements included in the registration statement, and (c) compliance as to form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations. An appropriate manner of expressing the comments is shown in paragraph 5a of example A.

23. When the most recent figures included in a condensed statement of income are for a period of less than one year, the SEC requires that comparative figures be shown for the corresponding short period of the preceding year. The condensed financial information for the latest interim period and the preceding year is ordinarily unaudited. In these circumstances, the unaudited status of the condensed interim financial information should be made clear in the comfort letter (see paragraph 3 of example A and paragraph 21e of this Statement).

Capsule Financial Information

24. In some registration statements, the information shown in the audited financial statements or unaudited condensed interim financial information is supplemented by unaudited summarized interim information for subsequent periods (commonly called “capsule financial information”). This capsule financial information (either in narrative or tabular form) is often provided for the most recent interim period and for the corresponding period of the prior year. With regard to selected capsule financial information, the accountants —

- a. May give negative assurance with regard to conformity with generally accepted accounting principles and may refer to whether the dollar amounts were determined on a basis substantially consistent with that of the corresponding amounts in the audited financial statements if the selected capsule financial information is presented in accordance with the minimum disclosure requirements of APB Opinion No. 28, paragraph 30 (Financial Accounting Standards Board [FASB], *Current Text*, vol. 1, AC sec. 173.146).

- b. May refer only to whether the dollar amounts were determined on a basis substantially consistent with that of the corresponding amounts in the audited financial statements if the selected capsule financial information is more limited than the minimum disclosures described in APB Opinion No. 28, paragraph 30 (see example L).

25. The underwriter occasionally asks the accountants to give negative assurance with respect to the unaudited interim financial statements or unaudited condensed interim financial information (see the interim financial information requirements of Regulation S-X) that underlie the capsule financial information and asks the accountants to state that the capsule financial information agrees with amounts set forth in such statements. Paragraphs 4*b* and 5*b* in example L provide an example of the accountants' comments in these circumstances.

26. The underwriter might ask the accountants to give negative assurance on the unaudited condensed interim financial information, or information extracted therefrom (that is, changes in net current assets), for a period ending after the latest financial statements included in the registration statement. In those cases, the unaudited condensed interim financial information should be attached to the comfort letter so that it is clear what financial information is being referred to. If the client requests, the unaudited condensed interim financial information may be attached only to the copy of the letter intended for the managing underwriter.

Subsequent Changes

27. Comments regarding subsequent changes should always be in the form of negative assurance. These comments should ordinarily relate to whether there has been any change in capital stock or long-term debt or "decreases" in other specified financial statement items during a period known as the "change period" (see paragraph 29). Usually, these comments would also address subsequent changes in the amounts of (a) net current assets or stockholders' equity and (b) net sales and the total and per-share amounts of income before extraordinary items and of net income. In order that comments on subsequent changes be unambiguous and their determination be within accountants' professional expertise, the comments should not relate to "adverse changes," since that term has not acquired any clearly understood meaning. If there has been a change in accounting principle during the change period, the accountants should note that fact in the letter. An appropriate manner of expressing the comments regarding subsequent changes is shown in paragraph 5*b* of example A if there has been no decrease and in example M if there has been a decrease.

28. Matters to be covered by the letter should be made clear in the meetings with the underwriter and should be identified in the underwriting agreement and in the draft comfort letter. Since there is no way of anticipating other matters that would be of interest to an underwriter, accountants should not make a general statement in a comfort letter that, as a result of carrying out the specified procedures, nothing else has come to their attention that would be of interest to the underwriter.

29. In the context of a comfort letter, a decrease occurs when the amount of a financial statement item at the cutoff date or for the change period (as if financial statements and their notes had been prepared at that date and for that period) is less than the amount of the same item at a specified earlier date or for a specified earlier period. With respect to the items mentioned in paragraph 27, the term *decrease* means (a) any combination of changes in amounts of current assets and current liabilities that results in decreased net current assets, (b) any combination of changes in amounts of assets and liabilities that results in decreased stockholders' equity, (c) decreased net sales, and (d) any combination of changes in amounts of sales, expenses, and outstanding shares that results in decreased total and per-share amounts of income before extraordinary items and of net income (including, in each instance, a greater loss or other negative amount). The change period for which the accountants give negative assurance in the comfort letter ends on the cutoff date (see paragraph 11) and ordinarily begins, for balance sheet items, immediately after the date of the latest balance sheet in the registration statement and, for income statement items, immediately after the latest period for which such items are presented in the registration statement. The comparison relates to the entire period and not to portions of that period. A decrease during one part of the period may be offset by an equal or larger increase in another part of the period; however, because there was no decrease for the period as a whole, the comfort letter would not report the decrease occurring during one part of the period (see, however, paragraph 48).

30. Underwriters occasionally request that the change period begin immediately after the date of the latest audited balance sheet (which is, ordinarily, also the closing date of the latest audited statement

of income) in the registration statement, even though the registration statement includes a more recent unaudited condensed balance sheet and condensed statement of income. The use of the earlier date may defeat the underwriter's purpose, since it is possible that an increase in one of the items referred to in paragraph 27 occurring between the dates of the latest audited and unaudited balance sheets included in the registration statement might more than offset a decrease occurring after the latter date. A similar situation might arise in the comparison of income statement items. In these circumstances, the decrease occurring after the date of the latest unaudited condensed interim financial statements included in the registration statement would not be reported in the comfort letter. It is desirable for the accountants to explain the foregoing considerations to the underwriter; however, if the underwriter nonetheless requests the use of a change period or periods other than those described in paragraph 29, the accountants may use the period or periods requested.

31. The underwriting agreement usually specifies the dates as of which, and periods for which, data at the cutoff date and data for the change period are to be compared. For balance sheet items, the comparison date is normally that of the latest balance sheet included in the registration statement (that is, immediately prior to the beginning of the change period). For income statement items, the comparison period or periods might be one or more of the following: (a) the corresponding period of the preceding year, (b) a period of corresponding length immediately preceding the change period, (c) a proportionate part of the preceding fiscal year, or (d) any other period of corresponding length chosen by the underwriter. Whether or not specified in the underwriting agreement, the date and period used in comparison should be identified in the comfort letter in both draft and final form so that there is no misunderstanding about the matters being compared and so that the underwriter can determine whether the comparison period is suitable for his or her purposes.

32. In addition to making the comparisons indicated above using the financial statements made available to them, the accountants will ordinarily be requested to read minutes and make inquiries of company officials relating to the whole of the change period.¹⁸ For the period between the date of the latest financial statements made available and the cutoff date, the accountants must necessarily base their comments solely on the limited procedures actually performed with respect to that period (which, in most cases, will be limited to the reading of minutes and the inquiries of company officials referred to in the preceding sentence), and their comfort letter should make this clear (see paragraph 6 of example A).

Disclosure in Registration Statement

33. Comments on the occurrence of changes in capital stock or long-term debt and decreases in other specified financial statement items are limited to changes or decreases not disclosed in the registration statement. Accordingly, the phrase "except for changes or decreases that the registration statement discloses have occurred or may occur" should be included in the letter when it has come to the accountants' attention that a change or decrease has occurred during the change period, and the change or decrease is disclosed in the registration statement. This phrase need not be included in the letter when no changes or decreases in the specified financial statement items are disclosed in the registration statement.

Effect on Comfort Letter When the Accountants' Report on Audited Financial Statements Is Modified

34. The foregoing discussion contemplates that the accountants' report on the audited financial statements and financial statement schedules in the registration statement is the accountants' standard report. When that report is modified, the accountants should refer to that fact in the opening paragraph of the comfort letter. For instance, if the accountants have added one or more explanatory paragraphs, or a paragraph to emphasize a matter regarding the financial statements, to their report on the historical financial statements, they should refer¹⁹ to that fact in the comfort letter and discuss the subject matter of the paragraph.²⁰ In those rare instances in which the SEC accepts a qualified opinion on historical financial statements, the accountants should refer to the qualification in the opening paragraph of the comfort letter and discuss the subject matter of the qualification.

¹⁸The answers to these inquiries generally should be supported by appropriate written representations of the company officials.

¹⁹The accountants may also refer in the opening paragraph to expansions of their report that do not affect their opinion, for example, expansions of their report regarding (a) interim financial information accompanying or included in the notes to audited financial statements (see paragraphs 29–30 of SAS No. 36) or (b) required supplementary information described in paragraphs 8–10 of SAS No. 52 (see paragraph 19 of this Statement).

²⁰The accountants need not refer to or discuss explanatory paragraphs covering consistency of application of accounting principles.

35. If the letter includes negative assurance with respect to subsequent unaudited condensed interim financial information included in the registration statement or with respect to an absence of specified subsequent changes or decreases, the effect thereon of the subject matter of the qualification, the explanatory paragraph(s), or the paragraph(s) emphasizing a matter regarding the financial statements should also be considered. An illustration of how this situation may be dealt with is shown in example I.

Other Accountants

36. Comfort letters are occasionally requested from more than one accountant (for example, in connection with registration statements to be used in the subsequent sale of shares issued in recently effected mergers). In these circumstances, each accountant must, of course, be sure he or she is independent within the meaning of the Act and the applicable published rules and regulations thereunder. In connection with opinions expressed prior to the acquisitions, the accountants for previously nonaffiliated companies recently acquired by the registrant would not be required to have been independent with respect to the company whose shares are being registered. In such a case, the accountants should modify the wording suggested in paragraph 15 and make a statement regarding their independence along the following lines:

As of [insert date of the accountants' most recent report on the financial statements of their client] and during the period covered by the financial statements on which we reported, we were independent certified public accountants with respect to [insert the name of their client] within the meaning of the Act and the applicable published rules and regulations thereunder.

37. There may be situations in which more than one accountant is involved in the audit of the financial statements of a business and in which the reports of more than one accountant appear in the registration statement. For example, certain significant divisions, branches, or subsidiaries may be audited by other accountants. The principal accountants (that is, those who report on the consolidated financial statements and, consequently, are asked to give a comfort letter with regard to information expressed on a consolidated basis) should read the letters of the other accountants reporting on significant units. Such letters should contain statements similar to those contained in the comfort letter prepared by the principal accountants, including statements about their independence. The principal accountants should state in their comfort letters that (a) reading letters of the other accountants was one of the procedures followed and (b) the procedures performed by the principal accountants (other than reading the letters of the other accountants) relate solely to (1) companies audited by the principal accountants and (2) the consolidated financial statements. An appropriate manner of expressing these comments when the letters of the other accountants do not disclose matters that affect the negative assurance given is shown in example J. If the letters of the other accountants disclose decreases in financial statement items or any other matters that affect the negative assurance that is given, the principal accountants should mention these matters in their letter. When appropriate, the principal accountants may comment that there were no decreases in the consolidated financial statement items despite the decreases mentioned by the other accountants. In such a case, the principal accountants could make a statement that "nothing came to our attention regarding the consolidated financial statements as a result of the specified procedures (which, as far as the related company was concerned, consisted solely of reading the other accountants' letter) that caused us to believe that . . ."

38. At the earliest practicable date, the client should advise any other accountants who may be involved about any letter that may be required from them and should arrange for them to receive a draft of the underwriting agreement so that they may make arrangements at an early date for the preparation of a draft of their letter (a copy of which should be furnished to the principal accountants) and for the performance of their procedures. In addition, the underwriter may desire to meet with the other accountants for the purposes discussed in paragraph 7.

39. When a comfort letter is furnished to other accountants, it should be addressed in accordance with paragraph 13 and copies should be furnished to the principal accountants and their client. The letter should contain a concluding paragraph similar to the example in paragraph 47.

Tables, Statistics, and Other Financial Information

40. The underwriting agreement sometimes calls for a comfort letter that includes comments on tables, statistics, and other financial information appearing in the registration statement.

41. The accountants should refrain from commenting on matters to which their competence as independent accountants has little relevance. Accordingly, except as indicated in the next sentence, they

should comment only with respect to information (a) that is expressed in dollars (or percentages derived from such dollar amounts) and that has been obtained from accounting records that are subject to the appropriate internal controls of the entity's accounting system or (b) that has been derived directly from such accounting records by analysis or computation. The accountants may also comment on quantitative information that has been obtained from an accounting record if the information is of a type that is subject to the same controls as the dollar amounts. Accountants should not comment on matters primarily involving the exercise of management's business judgment. For example, changes between periods in gross profit ratios or net income may be caused by factors that are not necessarily within the expertise of accountants. The accountants should not comment on matters merely because they happen to be present and are capable of reading, counting, measuring, or performing other functions that might be applicable. Examples of matters that, unless subjected to the appropriate internal controls of the accounting system (which is not ordinarily the case), should not be commented on by the accountants include the square footage of facilities, number of employees (except as related to a given payroll period), and backlog information. The accountants should not comment on tables, statistics, and other financial information relating to an unaudited period unless (a) they have performed an audit of the client's financial statements for a period including or immediately prior to the unaudited period or have completed an audit for a later period or (b) they have otherwise obtained knowledge of the client's internal control structure as provided for in paragraph 21f.

42. As with comments relating to financial statement information, it is important that the procedures followed by the accountants with respect to other information be clearly set out in the comfort letter, in both draft and final form, so that there will be no misunderstanding about the basis of the comments on the information. Further, so that there will be no implication that the accountants are furnishing any assurance with respect to the sufficiency of the procedures for the underwriter's intended purpose, it is advisable for the comfort letter to contain a statement to this effect. An appropriate way of expressing this is shown in paragraph 10 of example F (see also paragraph 9 of this Statement).

43. Certain financial information in registration statements is included because of specific requirements of Regulation S-K. Accountants may comment on whether this information is in conformity with the disclosure requirements of Regulation S-K if the following conditions are met:

- a. The information is derived from the accounting records subject to the appropriate internal controls of the entity's accounting system, or has been derived directly from such accounting records by analysis or computation.
- b. This information is capable of evaluation against reasonable criteria that have been established by the SEC.

The following are the disclosure requirements of Regulation S-K that generally meet these conditions:

- Item 301, "Selected Financial Data"
- Item 302, "Supplementary Financial Information"
- Item 402, "Executive Compensation"
- Item 503(d), "Ratio of Earnings to Fixed Charges"

Accountants may not give positive assurance on conformity with the disclosure requirements of Regulation S-K; they are limited to giving negative assurance, since this information is not given in the form of financial statements and has not generally been audited by the accountants. Even with respect to the abovementioned items, there may be situations in which it would be inappropriate to provide negative assurance with respect to conformity with Regulation S-K because conditions *a* and *b* above have not been met. For example, there may be uncertainty as to whether a highly paid employee should be listed as one of the highest paid executives. Since information relevant to Regulation S-K disclosure requirements other than those noted previously is generally not derived from the accounting records subject to the internal controls of the entity's accounting system, it is not appropriate for the accountants to comment on conformity with Regulation S-K. The accountants' inability to comment on conformity with Regulation S-K does not preclude accountants from performing procedures and reporting findings with respect to this data.

44. To avoid ambiguity, the specific information commented on in the letter should be identified by reference to specific captions, tables, page numbers, paragraphs, or sentences. Descriptions of the procedures followed and the findings obtained may be stated individually for each item of specific information commented on. Alternatively, if the procedures and findings are adequately described, some or all of the

descriptions may be grouped or summarized, if the descriptions do not imply that the accountants assume responsibility for the adequacy of the procedures and if it is unlikely that the applicability of the descriptions to items in the registration statement will be misunderstood. It would also be appropriate to present a matrix listing the financial information and common procedures employed and indicating the procedures applied to the specific items. Another presentation that could be used identifies procedures performed with specified symbols and identifies items to which those procedures have been applied directly on a copy of the prospectus which is attached to the comfort letter (see examples F, G, and H).

45. Comments in the comfort letter concerning tables, statistics, and other financial information included in the registration statement should be made in the form of a description of the procedures followed; the findings (ordinarily expressed in terms of agreement between items compared); and in some cases, as described below, statements with respect to the acceptability of methods of allocation used in deriving the figures commented on. Whether comments on the allocation of income or expense items between categories of sales (such as military and commercial sales) may appropriately be made will depend on the extent to which such allocation is made in, or can be derived directly by analysis or computation from, the client's accounting records. In any event, such comments, if made, should make clear that such allocations are to a substantial extent arbitrary, that the method of allocation used is not the only acceptable one, and that other acceptable methods of allocation might produce significantly different results. Furthermore, no comments should be made regarding segment information (or the appropriateness of allocations made to derive segment information) included in financial statements, since the accountants' report encompasses that information (see SAS No. 21, *Segment Information* [AICPA, *Professional Standards*, vol. 1, AU sec. 435]).²¹ Appropriate ways of expressing comments on tables, statistics, and other financial information are shown in examples F, G, and H.

46. In comments concerning tables, statistics, and other financial information, the expression "presents fairly" (or a variation of it) should not be used. That expression, when used by independent accountants, ordinarily relates to presentations of financial statements and should not be used in commenting on other types of information. Except with respect to requirements for financial statements and certain Regulation S-K items discussed in paragraph 43, the question of what constitutes appropriate information for compliance with the requirements of a particular item of the registration statement form is a matter of legal interpretation outside the competence of accountants. Consequently, the letter should state that the accountants make no representations regarding any matter of legal interpretation. Since the accountants will not be in a position to make any representations about the completeness or adequacy of disclosure or about the adequacy of the procedures followed, the letter should so state. It should point out as well that such procedures would not necessarily disclose material misstatements or omissions in the information to which the comments relate. An appropriate manner of expressing the comments is shown in examples F, G, and H.

Concluding Paragraph

47. To avoid any misunderstanding of the purpose and intended use of the comfort letter, it is desirable that the letter conclude with a paragraph along the following lines:

This letter is solely for the information of the addressees and to assist the underwriters²² in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and it is not to be used, circulated, quoted, or otherwise referred to within or without the underwriting group for any other purpose, including, but not limited to, the registration, purchase, or sale of securities, nor is it to be filed with or referred to in whole or in part in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or in any list of closing documents pertaining to the offering of the securities covered by the registration statement.

Miscellaneous

48. Accountants who discover matters that may require mention in the final comfort letter but that are not mentioned in the draft letter that has been furnished to the underwriter, such as decreases or changes in specified items not disclosed in the registration statement (see paragraphs 27 and 33), will

²¹See paragraph 19 regarding requests by an underwriter for comments on interim financial information required by item 302(a) of Regulation S-K and required supplementary information described in SAS No. 52.

²²When the letter is furnished by the accountants for a subsidiary and they are not also accountants for the parent company, the letter should include the following phrase at this point: "and for the use of the accountants for [name of issuer] in furnishing their letter for the underwriters."

naturally want to discuss them with their client so that consideration can be given to whether disclosure should be made in the registration statement. If disclosure is not to be made, the accountants should inform the client that the matters will be mentioned in the comfort letter and should suggest that the underwriter be promptly informed. It is recommended that the accountants be present when such matters are discussed between the client and the underwriter.

LETTERS TO A REQUESTING PARTY IN CONJUNCTION WITH FINANCING TRANSACTIONS

In General

49. The services of independent accountants also include audits of financial statements that are used in connection with certain financing transactions (see paragraph 1 for the definition of a financing transaction). In connection with this type of service, accountants may also be requested by a party to the transaction to perform additional procedures and report thereon. Accountants may provide letters to such parties as long as they comply with the guidance in this section (paragraphs 49–61).

50. The accountants should suggest to the requesting party that they meet together with the client to discuss the procedures to be followed in connection with such a letter. Any statements or implications that the accountants are carrying out such procedures as they consider necessary should be avoided, since this may lead to misunderstanding about the responsibility of the requesting party for the sufficiency of the procedures for their purposes. The accountants should refer to paragraph 7 for further guidance.

51. The guidance in paragraph 9 regarding obtaining a copy of any relevant agreements and furnishing the requesting party with a draft letter that has a legend describing its purposes and limitations may be helpful to the accountants in obtaining concurrence that the procedures to be performed by the accountants are sufficient for the purposes of the requesting party in connection with the financing transaction.

Dating

52. Agreements relating to the financing transaction may specify a date, often referred to as the “cutoff date,” to which the letter is to relate (for example, a date five days before the anticipated completion date of the financing). The letter should state that the inquiries and other procedures carried out at the request of the party to the transaction did not cover the period from the cutoff date to the date of the financing transaction. If more than one letter is requested, it will be necessary to carry out the specified procedures and inquiries to the cutoff date for each letter.

Addressee

53. The letter should not be addressed or given to any party other than the client and the requesting party who have agreed on the procedures to be performed.

Introductory Paragraph

54. It is desirable to include in the letter an introductory paragraph similar to the following:

We have audited the *[identify the financial statements audited]* included in (attached to) the offering circular (or other appropriate document); our report(s) with respect thereto is (are) included in (attached to) that offering circular. This offering circular, dated _____, is hereinafter referred to as the offering circular.

Accountants’ Reports

55. The accountants may refer in the introductory paragraphs of the letter to the fact that they have issued reports on—

- a. Condensed financial statements that are derived from audited financial statements (see SAS No. 42).
- b. Selected financial data (see SAS No. 42).
- c. A review of interim financial information (see SAS No. 36).
- d. An examination or a review of pro forma financial information (see Statement on Standards for Attestation Engagements *Reporting on Pro Forma Financial Information*).

- e. An examination or a compilation of a financial forecast (see Statement on Standards for Attestation Engagements *Financial Forecasts and Projections*).

Such a reference should be to the accountants' reports that were previously issued, and the reports, if not included in the offering circular, may be attached to the letter. The accountants, whether in response to a specific request to repeat their reports in the letter or in referring to previously issued reports, should not repeat those reports in the letter; furthermore, they should not otherwise imply that they are reporting as of the date of the letter or that they assume responsibility for the sufficiency of the procedures for the purposes of the requesting party.

56. Accountants are occasionally requested to repeat in a letter their report on previously audited financial statements. However, because of the special significance of the date of such a report, the accountants should not repeat their report. Accountants are sometimes requested to provide negative assurance regarding their report. Because the additional significance, if any, of negative assurance is unclear and such assurance may therefore give rise to misunderstanding, accountants should not give such negative assurance. Furthermore, the accountants should not comment on financial statements that have been audited and have been reported on by other accountants.

57. Accountants may also be requested to comment in their letter on unaudited interim financial information, to which SAS No. 36 pertains, or required supplementary information, to which SAS No. 52 pertains. SAS Nos. 36 and 52 provide that accountants should expand the standard report on the audited financial statements when the scope or procedures with regard to the information was restricted or when the information appears not to be presented in conformity with generally accepted accounting principles or, for required supplementary information, applicable guidelines. Such expansions of the accountants' standard report in an offering circular would ordinarily be referred to in the opening paragraph of the letter (see paragraph 34). Additional comments on such unaudited information are therefore unnecessary. However, if accountants are requested to perform procedures with regard to such information, in addition to the procedures performed in connection with the audit as prescribed by SAS Nos. 36 and 52, the accountants may do so and report their findings.

Reporting on Information Other Than Audited Financial Statements

58. Comments included in the letter will often concern (a) unaudited condensed interim financial statements, (b) capsule financial information, (c) changes in capital stock and long-term debt and decreases in other specified financial statement line items (referred to as "subsequent decreases or changes"), (d) pro forma financial information, and (e) financial forecasts. For commenting on these matters, the following guidance is important:

- a. Any statements by accountants with respect to unaudited condensed interim financial information, capsule financial information, pro forma financial information, financial forecasts, and subsequent changes or decreases should be limited to procedures performed and findings obtained. The accountants should not provide negative assurance based on agreed-upon procedures with respect to these items.
- b. The agreed-upon procedures performed by the accountants and the related findings should be set forth in the letter.
- c. To avoid any misunderstanding about responsibility for the sufficiency of procedures for the requesting party's purposes, the accountants should not make any statement, or imply, that they have applied procedures that they have determined to be necessary or sufficient for the requesting party's purposes. In this respect, the requesting party may ask the accountants to perform procedures similar to the inquiries and analytical procedures described in paragraph 6 of SAS No. 36. However, for the accountants to include such procedures in their letter, the requesting party would have to provide criteria that are sufficiently specific that there is no implication that the responsibility for sufficiency of the agreed-upon procedures has been assumed by the accountants. For example, if the requesting party asks the accountants to apply analytical procedures and specifies items of financial information to be reviewed and the materiality level for changes in those items that would necessitate further inquiry by the accountants, the accountants may refer to those procedures in their letter. The letter should include descriptions of the criteria specified by the requesting party along with a description of the procedures.
- d. Terms of uncertain meaning (such as *general review*, *limited review*, *check*, or *test*) should not be used in describing the work, unless the procedures comprehended by these terms are described in the letter.

- e. The letter should specifically identify any unaudited condensed interim financial information and should state that the accountants have not audited the condensed interim financial information in accordance with generally accepted auditing standards and do not express an opinion concerning such information.
- f. The accountants should not comment on unaudited condensed interim financial information, capsule financial information, or changes or decreases unless (1) they have performed an audit of the historical financial statements of the entity for the period presented or, in the case of interim periods, for the latest fiscal period that includes or precedes the interim period or (2) they have otherwise obtained knowledge of the client's internal control structure relating to the preparation of financial statements. An understanding of the client's practices in preparing its most recent annual financial statements provides a practical basis for the accountants' inquiries or procedures. However, if for whatever reason the accountants have not conducted such an audit, the need for an understanding of the client's internal control structure is not diminished and the accountants should consider whether, under the circumstances, they can acquire sufficient knowledge of those matters to perform the inquiries and procedures requested.
- g. Accountants should state in the letter that the procedures followed with respect to interim periods may not disclose changes in capital stock or long-term debt or decreases in the specified financial statement line items, inconsistencies in the application of generally accepted accounting principles, or other matters.
- h. Accountants should not comment on the application of pro forma adjustments to historical financial information or the compilation of pro forma financial information unless (1) they have performed an audit of the historical financial statements of the entity (or, in the case of business combinations, of a significant constituent part of the combined entity) for the period presented or, in the case of interim periods, for the latest fiscal period that includes or precedes the interim period or (2) they have otherwise obtained knowledge of the entity's internal control structure as provided for in item f above.
- i. The accountants should not comment on a financial forecast for which historical financial information provides a basis for one or more significant assumptions unless (1) they have performed an audit of such historical financial statements of the entity or (2) they have otherwise obtained knowledge of the client's internal control structure as provided for in item f above.
- j. Since the party requesting letters in connection with these financing transactions does not have a duty to perform due diligence procedures as a defense against possible claims under the Act, accountants should include the following caveats²⁹ in their letters in addition to those required in letters for underwriters:
 - "The procedures should not be taken to supplant the additional inquiries and procedures that [name of requesting party] should undertake in its consideration of the proposed transaction referred to above."
 - "Furthermore, in stating the procedures performed and results obtained, we have assumed that no information has come to the attention of [name of requesting party] that, if disclosed, could have materially affected our findings."
 - "We have no responsibility to update the letter for events and circumstances occurring after [cutoff date]."

**Effect on Letter of the Accountants' Report on Audited Financial Statements
When It Is Other Than the Standard Audit Report**

59. Accountants may refer to the general guidance in paragraph 34 regarding the effect on the letter when the audit report on the most recent annual financial statements is modified.

Other Accountants

60. There may be situations in which more than one accountant is involved in the audit of the financial statements. For example, certain significant divisions, branches, or subsidiaries may be audited by other accountants. In such cases, accountants should follow the guidance provided in paragraphs 37–39 of this Statement.

²⁹See the guidance in paragraphs 62–65 regarding matters relating to solvency. When letters are issued under the circumstances discussed in paragraphs 62–65, accountants should also include in the letter a statement that no assurance is provided concerning the borrower's (1) solvency, (2) adequacy of capital, or (3) ability to pay its debts.

Tables, Statistics, and Other Financial Information

61. Accountants may perform procedures with respect to tables, statistics, and other financial information included in any offering document as long as the conditions in paragraph 41 are met. Accountants should follow the general guidance in paragraphs 41–42 and 44–46.

LETTERS IN CONNECTION WITH MATTERS RELATING TO SOLVENCY

62. As a requisite to the closing of certain secured financings in connection with leveraged buyouts, recapitalizations, and certain other financial transactions, lenders have sometimes requested written assurance from accountants regarding the prospective borrower's solvency and related matters.²⁴ The lender is concerned that such financings not be considered to include a fraudulent conveyance or transfer under the Federal Bankruptcy Code²⁵ or the relevant state fraudulent conveyance or transfer statute.²⁶ If the financing is subsequently determined to have included a fraudulent conveyance or transfer, repayment obligations and security interests may be set aside or subordinated to the claims of other creditors.

63. Accountants should not provide any form of assurance through examination, review, or agreed-upon procedures that an entity—

- Is not insolvent at the time the debt is incurred or would not be rendered insolvent thereby.
- Does not have unreasonably small capital.
- Has the ability to pay its debts as they mature.

In the context of particular transactions, other terms are sometimes used or defined by the parties as equivalents of or substitutes for the terms listed above (for example, fair salable value of assets exceeds liabilities). These terms, and those matters listed above, are hereinafter referred to as “matters relating to solvency.” The prohibition extends to providing assurance concerning all such terms.

64. The matters relating to solvency mentioned in paragraph 63 are subject to legal interpretation under, and varying legal definitions in, the Federal Bankruptcy Code and various state fraudulent conveyance and transfer statutes. Because these matters are not clearly defined in an accounting sense, and are therefore subject to varying interpretations, they do not provide accountants with the reasonable criteria required to evaluate the assertion. In addition, lenders are concerned with legal issues on matters relating to solvency and accountants are generally unable to evaluate or provide any form of assurance on these matters of legal interpretation. Therefore, accountants are precluded from giving any form of assurance on matters relating to solvency or any financial presentation of matters relating to solvency.

65. Accountants can provide a client and lender with an agreed-upon procedures report. In such an engagement, a client and lender may request that specified procedures be applied to various financial

²⁴Although the guidance in this section (paragraphs 62–65) describes requests from secured lenders and summarizes the potential effects of fraudulent conveyance or transfer laws on such lenders, this guidance is not limited to requests from lenders. All requests for assurance on matters relating to solvency are governed by the guidance in this section.

²⁵Section 548 of the Federal Bankruptcy Code defines fraudulent transfers and obligations as follows:

The trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

- 1) made such transfer or incurred such obligation with actual intent to hinder, delay or defraud any entity to which the debtor was or became, on or after the date that such transfer occurred or such obligation was incurred, indebted; or
- 2) (A) received less than reasonably equivalent value in exchange for such transfer or obligation; and
(B) (i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
(ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or
(iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

(*Bankruptcy Law Reporter* [Chicago: Commerce Clearing House, 1986], 1: 1339.)

²⁶State fraudulent conveyance or transfer statutes such as the Uniform Fraudulent Conveyance Act (UFCA) and the Uniform Fraudulent Transfer Act (UFTA) reflect substantially similar provisions. These state laws may be employed absent a declaration of bankruptcy or by a bankruptcy trustee under section 544(b) of the Federal Bankruptcy Code. Although the statute of limitations varies from state to state, in some states financing transactions may be vulnerable to challenge for up to six years from closing.

presentations (such as historical financial information, pro forma financial information, and prospective financial information), which can be useful to a client or lender in connection with a financing. See paragraphs 49–61 for guidance in preparing these letters.

EXAMPLES

66. The contents of letters for underwriters vary, depending on the extent of the information in the registration statement and the wishes of the underwriter. Shelf registration statements may have several closing dates and different underwriters. Descriptions of procedures and findings regarding interim financial statements, tables, statistics, or other financial information that is incorporated by reference from previous 1934 Act filings may have to be repeated in several comfort letters. To avoid restating these descriptions in each comfort letter, accountants may initially issue the comments in a format (such as an appendix) that can be referred to in, and attached to, subsequently issued comfort letters.

Example A: Typical Letter

67. A typical comfort letter includes –
- a. A statement regarding the independence of the accountants (paragraph 15).
 - b. An opinion regarding whether the audited financial statements and financial statement schedules included in the registration statement comply as to form in all material respects with the applicable accounting requirements of the Act and related published rules and regulations (paragraphs 16 and 17).
 - c. Negative assurance on whether the unaudited condensed interim financial information included (incorporated by reference) in the registration statement (paragraphs 22 and 23) –
 1. Complies as to form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations.
 2. Is in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited financial statements included in the registration statement.
 - d. Negative assurance on whether, during a specified period following the date of the latest financial statements in the registration statement and prospectus, there has been any change in capital stock or long-term debt or any decrease in other specified financial statement items (paragraphs 21 and 27–32).

Example A is a letter covering all these items. Letters that cover some of the items may be developed by omitting inapplicable portions of example A.

Example A assumes the following circumstances.²⁷ The prospectus (part I of the registration statement) includes audited consolidated balance sheets as of December 31, 19X5 and 19X4, and audited consolidated statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 19X5. Part I also includes an unaudited consolidated condensed balance sheet as of March 31, 19X6, and unaudited consolidated condensed statements of income, retained earnings, and cash flows for the three-month periods ended March 31, 19X6 and 19X5. Part II of the registration statement includes consolidated financial statement schedules for the three years ended December 31, 19X5 (audited). The effective date is June 23, 19X6. The cutoff date is June 25, 19X6, and the letter is dated June 30, 19X6.

Each of the comments in the letter is in response to a requirement of the underwriting agreement. For purposes of example A, the income statement items of the current interim period are to be compared with those of the corresponding period of the preceding year.

June 30, 19X6

[Addressee]

Dear Sirs:

We have audited the consolidated balance sheets of The Blank Company, Inc. (the company) and subsidiaries as of December 31, 19X5 and 19X4, and the consolidated statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 19X5, and the related financial statement schedules all included in the registration statement (no. 33-00000) on Form S-1 filed by the company under the Securities Act of 1933 (the Act); our reports with respect thereto are also

²⁷The example includes financial statements required by SEC regulations to be included in the filing. If additional financial information is covered by the comfort letter, appropriate modifications should be made.

included in that registration statement. The registration statement, as amended on June 23, 19X6, is herein referred to as the registration statement.²⁸

In connection with the registration statement—

1. We are independent accountants with respect to The Blank Company, Inc., within the meaning of the Act and the applicable published rules and regulations thereunder.

2. In our opinion [*include the phrase “except as disclosed in the registration statement,” if applicable*], the consolidated financial statements and financial statement schedules audited by us and included in the registration statement comply as to form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations.

3. We have not audited any financial statements of the company as of any date or for any period subsequent to December 31, 19X5; although we have conducted an audit for the year ended December 31, 19X5, the purpose (and therefore the scope) of the audit was to enable us to express our opinion on the consolidated financial statements as of December 31, 19X5, and for the year then ended, but not on the financial statements for any interim period within that year. Therefore, we are unable to and do not express any opinion on the unaudited consolidated condensed balance sheet as of March 31, 19X6, and the unaudited consolidated condensed statements of income, retained earnings, and cash flows for the three-month periods ended March 31, 19X6 and 19X5, included in the registration statement, or on the financial position, results of operations, or cash flows as of any date or for any period subsequent to December 31, 19X5.

4. For the purposes of this letter we have read the 19X6 minutes of meetings of the stockholders, the board of directors, and [*include other appropriate committees, if any*] of the company and its subsidiaries as set forth in the minute books²⁹ at June 25, 19X6, officials of the company having advised us that the minutes of all such meetings through that date were set forth therein; and we have carried out other procedures to June 25, 19X6 (our work did not extend to the period from June 26, 19X6, to June 30, 19X6, inclusive), as follows:

- a. With respect to the three-month periods ended March 31, 19X6 and 19X5, we have—
 - (i) Read the unaudited consolidated condensed balance sheet as of March 31, 19X6, and unaudited consolidated condensed statements of income, retained earnings, and cash flows for the three-month periods ended March 31, 19X6 and 19X5, included in the registration statement; and
 - (ii) Made inquiries of certain officials of the company who have responsibility for financial and accounting matters regarding (1) whether the unaudited consolidated condensed financial statements referred to in a(i) comply as to form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations and (2) whether those unaudited consolidated condensed financial statements are in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements included in the registration statement.
- b. With respect to the period from April 1, 19X6, to May 31, 19X6, we have—
 - (i) Read the unaudited consolidated financial statements³⁰ of the company and subsidiaries for April and May of both 19X5 and 19X6 furnished us by the company, officials of the company having advised us that no such financial statements as of any date or for any period subsequent to May 31, 19X6, were available; and
 - (ii) Made inquiries of certain officials of the company who have responsibility for financial and accounting matters regarding whether the unaudited financial statements referred to in b(i) are stated on a basis substantially consistent with that of the audited financial statements included in the registration statement.

The foregoing procedures do not constitute an audit conducted in accordance with generally accepted auditing standards. Also, they would not necessarily reveal matters of significance with respect to the

²⁸The example assumes that the accountants have not previously reported on the interim financial information. If the accountants have previously reported on the interim financial information, they may refer to that fact in the introductory paragraphs of the comfort letter as follows:

Also, we have reviewed the unaudited consolidated condensed financial statements as of and for the three-month periods ended March 31, 19X6 and 19X5, as indicated in our report dated May 15, 19X6, which is included [*incorporated by reference*] in the registration statement.

The report may be attached to the comfort letter (see paragraph 20). In that circumstance, the procedure in paragraph 4a(ii)(2) of this example letter ordinarily would not be performed, and the accountants should not separately comment on conformity of the interim financial information with generally accepted accounting principles, since that negative assurance is encompassed in the accountants' review report attached to the comfort letter. The accountants may, however, agree to comment on whether the interim financial information complies as to form with the applicable accounting requirements of the published rules and regulations of the SEC.

²⁹The accountant should discuss with the secretary those meetings for which minutes have not been approved.

³⁰If the interim financial information is incomplete, a sentence similar to the following should be added: "The financial information for April and May is incomplete in that it omits the statements of cash flows and other disclosures."

comments in the following paragraph. Accordingly, we make no representations regarding the sufficiency of the foregoing procedures for your purposes.

5. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that—

- a. (i) The unaudited consolidated condensed financial statements described in 4a(i), included in the registration statement, do not comply as to form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations and (ii) the unaudited consolidated condensed financial statements are not in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements; or
- b. (i) The unaudited consolidated condensed financial statements of the company and its subsidiaries for April and May of both 19X5 and 19X6 are not stated on a basis substantially consistent with that of the audited consolidated financial statements³¹ or (ii) at May 31, 19X6, there was any change in the capital stock or long-term debt of the company and subsidiaries consolidated or any decrease in consolidated net current assets or stockholders' equity as compared with amounts shown in the March 31, 19X6 unaudited consolidated condensed balance sheet included in the registration statement or (iii) for the period from April 1, 19X6, to May 31, 19X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in the total or per-share amounts of income before extraordinary items or of net income, except in all instances for changes or decreases that the registration statement discloses have occurred or may occur.

6. As mentioned in 4b, company officials have advised us that no consolidated financial statements as of any date or for any period subsequent to May 31, 19X6, are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after May 31, 19X6, have, of necessity, been even more limited than those with respect to the periods referred to in 4. We have made inquiries of certain company officials who have responsibility for financial and accounting matters regarding whether (a) there was any change at June 25, 19X6, in the capital stock or long-term debt of the company and subsidiaries consolidated or any decreases in consolidated net current assets or stockholders' equity as compared with amounts shown on the March 31, 19X6 unaudited consolidated condensed balance sheet included in the registration statement or (b) for the period from April 1, 19X6, to June 25, 19X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in the total or per-share amounts of income before extraordinary items or of net income. On the basis of these inquiries and our reading of the minutes as described in 4, nothing came to our attention that caused us to believe that there was any such change or decrease, except in all instances for changes or decreases that the registration statement discloses have occurred or may occur.

7. This letter is solely for the information of the addressees and to assist the underwriters in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and it is not to be used, circulated, quoted, or otherwise referred to within or without the underwriting group for any purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to in whole or in part in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or in any list of closing documents pertaining to the offering of the securities covered by the registration statement.

Example B: Letter When a Short-Form Registration Statement Is Filed Incorporating Previously Filed Forms 10-K and 10-Q by Reference

68. Example B is applicable when a registrant uses a short-form registration statement (Form S-2 or S-3) which, by reference, incorporates previously filed Forms 10-K and 10-Q. It assumes that the short-form registration statement and prospectus include the Form 10-K for the year ended December 31, 19X5, and Form 10-Q for the quarter ended March 31, 19X6, which have been incorporated by reference. In addition to the information presented below, the letter would also contain paragraphs 6 and 7 of the typical letter in example A.

June 30, 19X6

[Addressee]

Dear Sirs:

We have audited the consolidated balance sheets of The Blank Company, Inc. (the company) and subsidiaries as of December 31, 19X5 and 19X4, and the consolidated statements of income, retained earnings,

³¹If there has been a change in accounting principle during the interim period, a reference to that change should be included herein.

and cash flows for each of the three years in the period ended December 31, 19X5, and the related financial statement schedules, all included [or incorporated by reference] in the company's annual report on Form 10-K for the year ended December 31, 19X5, and incorporated by reference in the registration statement (no. 33-00000) on Form S-3 filed by the company under the Securities Act of 1933 (the Act); our report with respect thereto is also incorporated by reference in that registration statement. The registration statement, as amended on May 31, 19X6, is herein referred to as the registration statement.

In connection with the registration statement—

1. We are independent certified public accountants with respect to the company within the meaning of the Act and the applicable published rules and regulations thereunder.

2. In our opinion, the consolidated financial statements and financial statement schedules audited by us and incorporated by reference in the registration statement comply as to form in all material respects with the applicable accounting requirements of the Act and the Securities Exchange Act of 1934 and the related published rules and regulations.

3. We have not audited any financial statements of the company as of any date or for any period subsequent to December 31, 19X5; although we have conducted an audit for the year ended December 31, 19X5, the purpose (and therefore the scope) of the audit was to enable us to express our opinion on the consolidated financial statements as of December 31, 19X5, and for the year then ended but not on the consolidated financial statements for any interim period within that year. Therefore, we are unable to and do not express any opinion on the unaudited consolidated condensed balance sheet as of March 31, 19X6, and the unaudited consolidated condensed statements of income, retained earnings, and cash flows for the three-month periods ended March 31, 19X6 and 19X5, included in the company's quarterly report on Form 10-Q for the quarter ended March 31, 19X6, incorporated by reference in the registration statement, or on the financial position, results of operations, or cash flows as of any date or for any period subsequent to December 31, 19X5.

4. For purposes of this letter, we have read the 19X6 minutes of the meetings of the stockholders, board of directors, and [*include other appropriate committees, if any*] of the company and its subsidiaries as set forth in the minute books at June 25, 19X6, officials of the company having advised us that the minutes of all such meetings through that date were set forth therein, and have carried out other procedures to June 25, 19X6 (our work did not extend to the period from June 26, 19X6, to June 30, 19X6, inclusive), as follows:

a. With respect to the three-month periods ended March 31, 19X6 and 19X5, we have—

- (i) Read the unaudited consolidated condensed financial statements for these periods, described in 3, included in the company's quarterly report on Form 10-Q for the quarter ended March 31, 19X6, incorporated by reference in the registration statement; and
- (ii) Made inquiries of certain officials of the company who have responsibility for financial and accounting matters regarding (1) whether the unaudited consolidated condensed financial statements referred to in *a(i)* comply as to form in all material respects with the applicable accounting requirements of the Securities Exchange Act of 1934 as it applies to Form 10-Q and the related published rules and regulations and (2) whether those unaudited consolidated condensed financial statements are in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements incorporated by reference in the registration statements.

b. With respect to the period from April 1, 19X6, to May 31, 19X6, we have—

- (i) Read the unaudited consolidated financial statements³² of the company and subsidiaries for April and May of both 19X5 and 19X6 furnished us by the company, officials of the company having advised us that no such financial statements as of any date or for any period subsequent to May 31, 19X6, were available; and
- (ii) Made inquiries of certain officials of the company who have responsibility for financial and accounting matters regarding whether the unaudited consolidated financial statements referred to in *b(i)* are stated on a basis substantially consistent with that of the audited consolidated financial statements incorporated by reference in the registration statement.

The foregoing procedures do not constitute an audit conducted in accordance with generally accepted auditing standards. In addition, they would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representations about the sufficiency of the foregoing procedures for your purposes.

5. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that—

- a. (i) The unaudited consolidated condensed financial statements described in 3, incorporated by reference in the registration statement, do not comply as to form in all material respects with the applicable accounting requirements of the Securities Exchange Act of 1934 as it applies to Form

³²See footnote 30.

10-Q and the related published rules and regulations; or (ii) the unaudited consolidated condensed financial statements are not in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements incorporated by reference in the registration statement; or

- b. (i) The unaudited consolidated condensed financial statements of the company and its subsidiaries for April and May for both 19X5 and 19X6 are not stated on a basis substantially consistent with that of the annual financial statements or (ii) at May 31, 19X6, there was any change in the capital stock or long-term debt of the company and consolidated subsidiaries or any decreases in consolidated net current assets or stockholders' equity as compared with amounts shown in the March 31, 19X6 unaudited consolidated condensed balance sheet incorporated by reference in the registration statement or (iii) for the period from April 1, 19X6, to May 31, 19X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in the total or per-share amounts of income before extraordinary items or of net income, except in all instances for changes or decreases that the registration statement discloses have occurred or may occur.

Example C: Letter Reaffirming Comments in Example A as of a Later Date

69. If more than one comfort letter is requested, the later letter may, in appropriate situations, refer to information appearing in the earlier letter without repeating such information (see paragraphs 12 and 66). Example C reaffirms and updates the information in example A.

July 25, 19X6

[Addressee]

Dear Sirs:

We refer to our letter of June 30, 19X6, relating to the registration statement (no. 33-00000) of The Blank Company, Inc. (the company). We reaffirm as of the date hereof (and as though made on the date hereof) all statements made in that letter except that, for the purposes of this letter—

- a. The registration statement to which this letter relates is as amended as of July 13, 19X6 [effective date].
- b. The reading of minutes described in paragraph 4 of that letter has been carried out through July 20, 19X6 [the new cutoff date].
- c. The procedures and inquiries covered in paragraph 4 of that letter were carried out to July 20, 19X6 [the new cutoff date] (our work did not extend to the period from July 21, 19X6, to July 25, 19X6 [date of letter], inclusive).
- d. The period covered in paragraph 4b of that letter is changed to the period from April 1, 19X6, to June 30, 19X6; officials of the company have advised us that the latest available financial statements are for the month of June 19X6.
- e. The references to May 31, 19X6, in paragraph 5b of that letter are changed to June 30, 19X6.
- f. The references to May 31, 19X6, and June 25, 19X6, in paragraph 6 of that letter are changed to June 30, 19X6, and July 20, 19X6, respectively.
- g. This letter is solely for the information of the addressees and to assist the underwriters in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and it is not to be used, circulated, quoted, or otherwise referred to within or without the underwriting group for any other purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to in whole or in part in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or any list of closing documents pertaining to the offering of the securities covered by the registration statement.

Example D: Comments on Pro Forma Financial Information

70. Example D is applicable when the accountants are asked to comment on (a) whether the pro forma financial information in a registration statement complies with the applicable accounting requirements of published rules and regulations of the SEC and (b) the application of pro forma adjustments to historical amounts in the compilation of the pro forma financial information (see paragraph 21h). The material in this example is intended to be inserted between paragraphs 6 and 7 of example A. The example assumes that the accountants have not previously reported on the pro forma financial information. If the accountants did previously report on the pro forma financial information, they may refer in the introductory paragraph of the comfort letter to the fact that they have issued a report, and the report may be attached to the comfort letter (see paragraph 20). In that circumstance, therefore, the procedures in 7b(i) and 7c ordinarily would not be performed, and the accountants should not separately comment on the

application of pro forma adjustments in the compilation of the pro forma financial information, since that assurance is encompassed in the accountants' report on pro forma financial information. The accountants may, however, agree to comment on compliance as to form with applicable accounting requirements of published rules and regulations of the SEC.

7. At your request, we have —

- a. Read the unaudited pro forma consolidated condensed balance sheet as of March 31, 19X6, and the unaudited pro forma consolidated condensed statements of income for the year ended December 31, 19X5, and the three-month period ended March 31, 19X6, included [incorporated by reference] in the registration statement.
- b. Made inquiries of certain officials of the company and of XYZ Company (the company being acquired) who have responsibility for financial and accounting matters about —
 - (i) The basis for their determination of the pro forma adjustments, and
 - (ii) Whether the unaudited pro forma consolidated condensed financial statements referred to in 7a comply as to form in all material respects with the applicable accounting requirements of Rule 11-02 of Regulation S-X.
- c. Proved the arithmetic accuracy of the application of the pro forma adjustments to the historical amounts in the unaudited pro forma consolidated condensed financial statements.

These agreed-upon procedures are substantially less in scope than an examination, the objective of which is the expression of an opinion on management's assumptions, the pro forma adjustments, and the application of those adjustments to historical financial information. Accordingly, we do not express such an opinion. The foregoing procedures would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representation about the sufficiency of such procedures for your purposes.

8. Nothing came to our attention as a result of the procedures specified in paragraph 7, however, that caused us to believe that the unaudited pro forma consolidated condensed financial statements referred to in 7a included [incorporated by reference] in the registration statement do not comply as to form in all material respects with the applicable accounting requirements of Rule 11-02 of Regulation S-X and that the pro forma adjustments have not been properly applied to the historical amounts in the compilation of those statements. Had we performed additional procedures or had we made an examination of the pro forma financial information, other matters might have come to our attention that would have been reported to you.

Example E: Comments on a Financial Forecast

71. Example E is applicable when accountants are asked to comment on a financial forecast. The material in this example is intended to be inserted between paragraphs 6 and 7 in example A. The example assumes that the accountants have previously reported on the compilation of the financial forecast and that the report is attached to the letter (see paragraph 20).

7. At your request, we performed the following procedure with respect to the forecasted balance sheet and statements of income and cash flows as of December 31, 19X6, and for the year then ending. With respect to forecasted rental income, we compared the assumptions about expected demand for rental of the housing units with demand for similar housing units at similar rental prices in the city area in which DEF Company's housing units are located.

8. Because the procedure described above does not constitute an examination of prospective financial statements in accordance with standards established by the American Institute of Certified Public Accountants, we do not express an opinion on whether the prospective financial statements are presented in conformity with AICPA presentation guidelines or on whether the underlying assumptions provide a reasonable basis for the presentation.

Nothing has come to our attention as a result of the procedure specified in 7 that caused us to believe that forecasted rental income should be adjusted. Had we performed additional procedures or had we made an examination of the forecast in accordance with standards established by the American Institute of Certified Public Accountants, matters might have come to our attention that would have been reported to you. Furthermore, there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material.

Example F: Comments on Tables, Statistics, and Other Financial Information

72. Example F is applicable when the accountants are asked to comment on tables, statistics, or other compilations of information appearing in a registration statement (paragraphs 40–46). Each of the comments is in response to a specific request. The paragraphs in example F are intended to follow paragraph 6 of example A.

7. For purposes of this letter, we have also read the following, set forth in the registration statement on the indicated pages.³³

<u>Item</u>	<u>Page</u>	<u>Description</u>
<i>a</i>	4	"Capitalization." The amounts under the captions "Amount Outstanding as of June 15, 19X6" and "As Adjusted." The related notes, except the following in Note 2: "See 'Transactions With Interested Persons.' From the proceeds of this offering the company intends to prepay \$900,000 on these notes, pro rata. See 'Use of Proceeds.'"
<i>b</i>	13	"History and Business — Sales and Marketing." The table following the first paragraph.
<i>c</i>	22	"Executive Compensation — 19X5 Compensation."
<i>d</i>	33	"Selected Financial Data." ³⁴

8. Our audit of the consolidated financial statements for the periods referred to in the introductory paragraph of this letter comprised audit tests and procedures deemed necessary for the purpose of expressing an opinion on such financial statements taken as a whole. For none of the periods referred to therein nor any other period did we perform audit tests for the purpose of expressing an opinion on individual balances of accounts or summaries of selected transactions such as those enumerated above, and, accordingly, we express no opinion thereon.

9. However, for purposes of this letter we have performed the following additional procedures, which were applied as indicated with respect to the items enumerated above.

<u>Item in 7</u>	<u>Procedures and Findings</u>
<i>a.</i>	We compared the amounts and numbers of shares listed under the caption "Amount Outstanding as of June 15, 19X6" with the balances in the appropriate accounts in the company's general ledger at May 31, 19X6 (the latest date for which postings had been made), and found them to be in agreement. We were informed by company officials who have responsibility for financial and accounting matters that there had been no changes in such amounts and numbers of shares between May 31, 19X6, and June 15, 19X6. We compared the amounts and numbers of shares listed under the caption "Amount Outstanding as of June 15, 19X6," adjusted for the issuance of the debentures to be offered by means of the registration statement and for the proposed use of a portion of the proceeds thereof to prepay portions of certain notes, as described under "Use of Proceeds," with the amounts and numbers of shares shown under the caption "As Adjusted" and found such amounts and numbers of shares to be in agreement. (However, we make no comments regarding the reasonableness of the "Use of Proceeds" or whether such use will actually take place.) We compared the description of the securities and the information (except certain information in Note 2, referred to in 7) included in the notes to the table with the corresponding descriptions and information in the company's consolidated financial statements, including the notes thereto included in the registration statement, and found such descriptions and information to be in agreement.
<i>b.</i>	We compared the amounts of military sales, commercial sales, and total sales shown in the registration statement with the balances in the appropriate accounts in the company's general ledger for the respective fiscal years and for the unaudited interim periods and found them to be in agreement. We computed the approximate percentages of such amounts of military sales and commercial sales to total sales for the respective fiscal years and for the unaudited interim periods. We compared the computed percentages with the corresponding percentages appearing in the registration statement and found them to be in agreement.
<i>c.</i>	We compared the dollar amounts of cash compensation for each individual listed in the table "Cash Compensation" with the corresponding amounts shown by the individual employee earnings records for the year 19X5 and found them to be in agreement. We compared the dollar amount of aggregate executive officers' cash compensation on page 22 with the corresponding amount shown in an analysis prepared by the company and found the amounts to be in agreement. We compared the dollar amounts shown under the headings of "Compensation Pursuant to Plans," "Stock Options," and "Other Compensation" on page 24 for each listed individual and the aggregate amounts for executive officers with corresponding amounts shown in an analysis prepared by the company and found such amounts to be in agreement.

³³In some cases it may be considered desirable to combine in one paragraph the substance of paragraphs 7 and 9. This may be done by expanding the identification of items in paragraph 9 to provide the identification information contained in paragraph 7. In such cases, the introductory sentences in paragraphs 7 and 9 and the text of paragraph 8 might be combined as follows: "For purposes of this letter, we have also read the following information and have performed the additional procedures stated below with respect to such information. Our audit of the consolidated financial statements . . ."

³⁴In some cases the company or the underwriters may request that the independent accountants report on "selected financial data" as described in SAS No. 42, *Reporting on Condensed Financial Statements and Selected Financial Data* (AICPA, *Professional Standards*, vol. 1, AU sec. 552). When the accountants report on these data and the report is included in the registration statement, separate comments should not be included in the comfort letter (see paragraph 20).

We compared the executive compensation information with the requirements of Item 402 of Regulation S-K. We also inquired of certain officials of the company who have responsibility for financial and accounting matters whether the executive compensation information conforms in all material respects with the disclosure requirements of Item 402 of Regulation S-K. Nothing came to our attention as a result of the foregoing procedures that caused us to believe that this information does not conform in all material respects with the disclosure requirements of Item 402 of Regulation S-K.

- d. We compared the amounts of net sales, income from continuing operations, income from continuing operations per common share, and cash dividends declared per common share for the years ended December 31, 19X5, 19X4, and 19X3, with the respective amounts in the consolidated financial statements on pages 27 and 28 and the amounts for the years ended December 31, 19X2 and 19X1, with the respective amounts in the consolidated financial statements included in the company's annual reports to stockholders for 19X2 and 19X1 and found them to be in agreement.

We compared the amounts of total assets, long-term obligations, and redeemable preferred stock at December 31, 19X5 and 19X4, with the respective amounts in the consolidated financial statements on pages 27 and 28 and the amounts at December 31, 19X3, 19X2, and 19X1, with the corresponding amounts in the consolidated financial statements included in the company's annual reports to stockholders for 19X3, 19X2, and 19X1 and found them to be in agreement.

We compared the information included under the heading "Selected Financial Data" to the requirements of Item 301 of Regulation S-K. We also inquired of certain officials of the company who have responsibility for financial and accounting matters whether this information conforms in all material respects with the disclosure requirements of Item 301 of Regulation S-K. Nothing came to our attention as a result of the foregoing procedures that caused us to believe that this information does not conform in all material respects with the disclosure requirements of Item 301 of Regulation S-K.

10. It should be understood that we make no representations regarding questions of legal interpretation or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraph; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages listed above. Further, we have addressed ourselves solely to the foregoing data as set forth in the registration statement and make no representations regarding the adequacy of disclosure or whether any material facts have been omitted.

11. This letter is solely for the information of the addressees and to assist the underwriters in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and it is not to be used, circulated, quoted, or otherwise referred to within or without the underwriting group for any other purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to in whole or in part in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or in any list of closing documents pertaining to the offering of the securities covered by the registration statement.

Example G: Summarized Description of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information

73. Example G illustrates, in paragraph 9a, a method of summarizing the descriptions of procedures and findings regarding tables, statistics, and other financial information in order to avoid repetition in the comfort letter. The summarization of the descriptions is permitted by paragraph 44. Each of the comments is in response to a specific request. The paragraphs in example G are intended to follow paragraph 6 in example A.³⁵

7. For purposes of this letter, we have also read the following, set forth in the registration statement on the indicated pages.

<u>Item</u>	<u>Page</u>	<u>Description</u>
a	4	"Capitalization." The amounts under the captions "Amount Outstanding as of June 15, 19X6" and "As Adjusted." The related notes, except the following in Note 2: "See 'Transactions With Interested Persons.' From the proceeds of this offering the company intends to prepay \$900,000 on these notes pro rata. See 'Use of Proceeds.'"
b	13	"History and Business—Sales and Marketing." The table following the first paragraph.
c	22	"Executive Compensation—19X5 Compensation."
d	33	"Selected Financial Data." ³⁶

³⁵Other methods of summarizing the descriptions may also be appropriately used. For example, the letter may present a matrix listing the financial information and common procedures employed and indicating the procedures applied to specific items.

³⁶See footnote 34.

8. Our audit of the consolidated financial statements for the periods referred to in the introductory paragraph of this letter comprised audit tests and procedures deemed necessary for the purpose of expressing an opinion on such financial statements taken as a whole. For none of the periods referred to therein nor any other period did we perform audit tests for the purpose of expressing an opinion on individual balances of accounts or summaries of selected transactions such as those enumerated above, and, accordingly, we express no opinion thereon.

9. However, for purposes of this letter and with respect to the items enumerated in 7 above—

- a. Except for item 7a, we have (i) compared the dollar amounts either with the amounts in the audited consolidated financial statements described in the introductory paragraph of this letter or, for prior years, included in the company's annual report to stockholders for the years 19X1, 19X2, and 19X3 or with amounts in the unaudited consolidated financial statements described in paragraph 3 to the extent such amounts are included in or can be derived from such statements and found them to be in agreement; (ii) compared the amounts of military sales, commercial sales, and total sales and the dollar amounts of cash compensation for each listed individual with amounts in the company's accounting records and found them to be in agreement; (iii) compared other dollar amounts with amounts shown in analyses prepared by the company and found them to be in agreement; and (iv) proved the arithmetic accuracy of the percentages based on the data in the abovementioned financial statements, accounting records, and analyses.

We compared the information in items 7c and 7d with the disclosure requirements of Regulation S-K. We also inquired of certain officials of the company who have responsibility for financial and accounting matters whether this information conforms in all material respects with the disclosure requirements of Regulation S-K. Nothing came to our attention as a result of the foregoing procedures that caused us to believe that this information does not conform in all material respects with the disclosure requirements of Items 402 and 301, respectively, of Regulation S-K.

- b. With respect to item 7a, we compared the amounts and numbers of shares listed under the caption "Amount Outstanding as of June 15, 19X6" with the balances in the appropriate accounts in the company's general ledger at May 31, 19X6 (the latest date for which postings had been made), and found them to be in agreement. We were informed by officials of the company who have responsibility for financial and accounting matters that there had been no changes in such amounts and numbers of shares between May 31, 19X6, and June 15, 19X6. We compared the amounts and numbers of shares listed under the caption "Amount Outstanding as of June 15, 19X6" adjusted for the issuance of the debentures to be offered by means of the registration statement and for the proposed use of a portion of the proceeds thereof to prepay portions of certain notes, as described under "Use of Proceeds," with the amounts and numbers of shares shown under the caption "As Adjusted" and found such amounts and numbers of shares to be in agreement. (However, we make no comments regarding the reasonableness of "Use of Proceeds" or whether such use will actually take place.) We compared the description of the securities and the information (except certain information in Note 2, referred to in 7) included in the notes to the table with the corresponding descriptions and information in the company's consolidated financial statements, including the notes thereto, included in the registration statement and found such descriptions and information to be in agreement.

10. It should be understood that we make no representations regarding questions of legal interpretation or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraph; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages listed above. Further, we have addressed ourselves solely to the foregoing data as set forth in the registration statement and make no representations regarding the adequacy of disclosure or regarding whether any material facts have been omitted.

11. This letter is solely for the information of the addressees and to assist the underwriters in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and it is not to be used, circulated, quoted, or otherwise referred to within or without the underwriting group for any other purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to in whole or in part in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or in any list of closing documents pertaining to the offering of the securities covered by the registration statement.

Example H: Descriptions of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information—With Attached Registration Statement (or Selected Pages) Identifying, With Designated Symbols, Items to Which Procedures Were Applied

74. This example illustrates an alternate format that could facilitate reporting when the accountant is requested to perform procedures on numerous statistics included in a registration statement. This format is permitted by paragraph 44. Each of the comments is in response to a specific request. The paragraph in example H is intended to follow paragraph 6 in example A.

7. For purposes of this letter, we have also read the items identified by you on the attached copy of the registration statement (prospectus) and have performed the following procedures, which were applied as indicated with respect to the symbols explained below:

- ✓ Compared the amount with the XYZ (Predecessor Company) financial statements for the period indicated and found them to be in agreement.
- ✗ Compared the amount with the XYZ (Predecessor Company) financial statements for the period indicated contained in the registration statement and found them to be in agreement.
- ✓ Compared the amount with ABC's financial statements for the period indicated contained in the registration statement and found them to be in agreement.
- Ⓢ Compared with a schedule or report prepared by the Company and found them to be in agreement.

The letter would also contain paragraphs 10 and 11 of the letter in example F.

(The following is an extract from a registration statement that illustrates how an accountant can document procedures performed on numerous statistics included in the registration statement.)

The following summary is qualified in its entirety by the financial statements and detailed information appearing elsewhere in this Prospectus.

The Company

ABC Company (the "Company") designs, constructs, sells, and finances single-family homes for the entry-level and move-up home buyer. The Company and its predecessor have built and delivered more single-family homes in the metropolitan area than any other home builder for each of the last five years. The Company delivered Ⓢ 1,000 homes in the year ending December 31, 19X5, and at December 31, 19X5, had 500 homes³⁷ under contract with an aggregate sales price of approximately \$45,000,000. The Company's wholly owned mortgage banking subsidiary, which commenced operations in March 19X5, currently originates a substantial portion of the mortgages for homes sold by the Company.

The Company typically does not engage in land development without related home-building operations and limits speculative building. The Company purchases only that land that it is prepared to begin developing immediately for home production. A substantial portion of the Company's homes are under contract for sale before construction commences.

The DEF area has been among the top five markets in the country in housing starts for each of the last five years, with more than 90,000 single-family starts during that period. During the same period, the DEF metropolitan area has experienced increases in population, personal income, and employment at rates above the national average. The Company is a major competitive factor in three of the seven market areas, and is expanding significantly in a fourth area.

The Offering

Common Stock Offered by the Company 750,000 Ⓢ shares of Common Stock—\$.01 par value
(the "Common Stock")*

Common Stock to Be Outstanding 3,250,000 Ⓢ shares*

Use of Proceeds To repay indebtedness incurred for the acquisition
of the Company

Proposed NASDAQ Symbol ABC

*Assumes no exercise of the Underwriters' overallotment option. See "Underwriting."

Summary Financial Information (In thousands, except per-share data)

<u>Income Statement Data</u>	<u>XYZ (Predecessor Company)</u> <u>Year Ended December 31</u>				<u>ABC</u> <u>Company</u> <u>Year Ended</u> <u>December 31,</u> <u>19X5</u>
	<u>19X1</u>	<u>19X2</u>	<u>19X3</u>	<u>19X4</u>	
Revenue from home sales	\$106,603 ✓	\$88,977 ✓	\$104,110 ✗	\$115,837 ✗	\$131,032 ✓
Gross profit from sales	15,980 ✓	21,138 ✓	23,774 ✗	17,099 ✗	22,407 ✓
Income from home building net of tax	490 ✓	3,473 ✓	7,029 ✗	1,000 ✗	3,425 ✓
Earnings per share	—	—	—	—	\$ 1.37 ✓

³⁷See paragraph 41.

Example I: Alternate Wording When Accountants' Report on Audited Financial Statements Contains an Explanatory Paragraph

75. Example I is applicable when the accountants' report on the audited financial statements included in the registration statement contains an explanatory paragraph regarding a matter that would also affect the unaudited consolidated condensed interim financial statements included in the registration statement. The introductory paragraph in example A would be revised as follows:

Our reports with respect thereto (which contain an explanatory paragraph that describes a lawsuit to which the Company is a defendant, discussed in note 8 to the financial statements) are also included in the registration statement.

The matter described in the explanatory paragraph should also be evaluated to determine whether it also requires mention in the comments on the unaudited consolidated condensed interim financial information (paragraph 5*b* of example A).

If it is concluded that mention of such a matter in the comments on unaudited financial statements is appropriate, a sentence such as the following should be added at the end of paragraph 5*b* in example A:

Reference should be made to the introductory paragraph of this letter which states that our audit report covering the financial statements as of and for the year ended December 31, 19X5, includes an explanatory paragraph that describes a lawsuit to which the Company is a defendant, discussed in note 8 to the financial statements.

Example J: Alternate Wording When More Than One Accountant Is Involved

76. Example J applies when more than one accountant is involved in the audit of the financial statements of a business and the principal accountants have obtained a copy of the comfort letter of the other accountants (paragraph 37). Example J consists of an addition to paragraph 4*c*, a substitution for the applicable part of paragraph 5, and an addition to paragraph 6 of example A.

[4]*c*. We have read the letter dated _____ of [the other accountants] with regard to [the related company].

5. Nothing came to our attention as a result of the foregoing procedures (which, so far as [the related company] is concerned, consisted solely of reading the letter referred to in 4*c*), however, that caused us to believe that . . .

6. . . . On the basis of these inquiries and our reading of the minutes and the letter dated _____ of [the other accountants] with regard to [the related company], as described in 4, nothing came to our attention that caused us to believe that there was any such change or decrease, except in all instances for changes or decreases that the registration statement discloses have occurred or may occur.

Example K: Alternate Wording When the SEC Has Agreed to a Departure From Its Published Accounting Requirements

77. Example K is applicable when (a) there is a departure from the applicable accounting requirements of the Act and the related published rules and regulations and (b) representatives of the SEC have agreed to the departure. Paragraph 2 of example A would be revised to read as follows:

2. In our opinion [include the phrase "except as disclosed in the registration statement," if applicable], the financial statements and financial statement schedules audited by us and included or incorporated by reference in the registration statement comply as to form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations; however, as agreed to by representatives of the SEC, separate financial statements and financial statement schedules of ABC Company (an equity investee) as required by Rule 3-09 of Regulation S-X have been omitted.

Example L: Alternate Wording When Recent Earnings Data Are Presented in Capsule Form

78. Example L is applicable when (a) the statement of income in the registration statement is supplemented by later information regarding sales and earnings (capsule financial information) and (b) the accountants are asked to comment on that information (paragraph 24). The same facts exist as in example A, except for the following:

a. Sales, net income (no extraordinary items), and earnings per share for the six-month periods ended

June 30, 19X6 and 19X5 (both unaudited), are included in capsule form more limited than that specified by APB Opinion No. 28 (FASB, *Current Text*, vol. 1, AC sec. I73.146).

- b. No financial statements later than those for June 19X6 are available.
- c. The letter is dated July 25, 19X6, and the cutoff date is July 20, 19X6.

Paragraphs 4, 5, and 6 of example A should be revised to read as follows:

4. For purposes of this letter we have read the 19X6 minutes . . . and have carried out other procedures to July 20, 19X6 (our work did not extend to the period from July 21, 19X6, to July 25, 19X6, inclusive), with respect to the six-month periods ended June 30, 19X6 and 19X5, as follows:

- a. Read the unaudited consolidated condensed balance sheet as of March 31, 19X6, and the unaudited consolidated condensed statements of income, retained earnings, and cash flows for the three-month periods ended March 31, 19X6 and 19X5, included in the registration statement.
- b. Read the unaudited amounts for sales, net income, and earnings per share for the six-month periods ended June 30, 19X6 and 19X5, as set forth in the paragraph [*identify location*] and read the unaudited consolidated financial statements furnished us by the company for those periods, from which those amounts were derived.
- c. Made inquiries of certain officials of the company who have responsibility for financial and accounting matters regarding (i) whether the unaudited consolidated condensed financial statements referred to in *a* comply as to form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations, (ii) whether those unaudited consolidated condensed financial statements are in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the unaudited consolidated financial statements included in the registration statement, and (iii) whether the unaudited amounts referred to in *b* are stated on a basis substantially consistent with that of the corresponding amounts in the audited consolidated statements of income.

The foregoing procedures do not constitute an audit conducted in accordance with generally accepted auditing standards. Also, they would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representations regarding the sufficiency of the foregoing procedures for your purposes.

5. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that—

- a. (i) The unaudited consolidated condensed financial statements described in 4a, included in the registration statement, do not comply as to form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations or (ii) those unaudited consolidated condensed financial statements are not in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements;
- b. The unaudited sales and net income amounts, referred to in 4b, (i) do not agree with the amounts set forth in the unaudited consolidated financial statements for those same periods or (ii) were not determined on a basis substantially consistent with that of the corresponding amounts in the audited consolidated statements of income; or
- c. At June 30, 19X6, there was any change in the capital stock or long-term debt of the company and subsidiaries consolidated or any decreases in consolidated net current assets or stockholders' equity as compared with amounts shown in the March 31, 19X6 unaudited consolidated condensed balance sheet included in the registration statement, except for changes or decreases that the registration statement discloses have occurred or may occur.

6. Company officials have advised us that no consolidated financial statements as of any date or for any period subsequent to June 30, 19X6, are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after June 30, 19X6, have, of necessity, been even more limited than those with respect to the periods referred to in 4. We have made inquiries of certain officials of the company who have responsibility for financial and accounting matters regarding whether (a) at July 20, 19X6, there was any change in the capital stock or long-term debt of the company and subsidiaries consolidated or any decreases in consolidated net current assets or stockholders' equity as compared with amounts shown on the March 31, 19X6 unaudited consolidated condensed balance sheet included in the registration statement; or (b) for the period from July 1, 19X6, to July 20, 19X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in the total or per-share amount of income before extraordinary items or of net income. On the basis of these inquiries and our reading of the minutes as described in 4, nothing came to our attention that caused us to believe that there was any such change or decrease, except in all instances for changes or decreases that the registration statement discloses have occurred or may occur.

Example M: Alternate Wording When Accountants Are Aware of a Decrease in a Specified Financial Statement Item

79. Example M covers a situation in which accountants are aware of a decrease in a financial statement item on which they are requested to comment (paragraphs 27–32). The same facts exist as in example A, except for the decrease covered in the following change in paragraph 5*b*.

- b.* (i) The unaudited consolidated condensed financial statements³⁸ of the company and its subsidiaries for April and May of both 19X5 and 19X6 are not stated on a basis substantially consistent with that of the annual financial statements or (ii) at May 31, 19X6, there was any change in the capital stock or long-term debt of the company and subsidiaries consolidated or any decrease in consolidated stockholders' equity as compared with amounts shown in the March 31, 19X6 unaudited consolidated condensed balance sheet included in the registration statement or (iii) for the period from April 1, 19X6, to May 31, 19X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or the total or per-share amounts of income before extraordinary items or of net income, except in all instances for changes or decreases that the registration statement discloses have occurred or may occur and except that the unaudited consolidated balance sheet as of May 31, 19X6, which we were furnished by the company, showed a decrease from March 31, 19X6, in consolidated net current assets as follows (in thousands of dollars):

	<i>Current Assets</i>	<i>Current Liabilities</i>	<i>Net Current Assets</i>
March 31, 19X6	\$4,251	\$1,356	\$2,895
May 31, 19X6	3,986	1,732	2,254

6. As mentioned in 4*b*, company officials have advised us that no consolidated financial statements as of any date or for any period subsequent to May 31, 19X6, are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after May 31, 19X6, have, of necessity, been even more limited than those with respect to the periods referred to in 4. We have made inquiries of certain officials of the company who have responsibility for financial and accounting matters regarding whether (a) there was any change at June 25, 19X6, in the capital stock or long-term debt of the company and subsidiaries consolidated or any decreases in consolidated net current assets or stockholders' equity as compared with amounts shown on the March 31, 19X6 unaudited consolidated condensed balance sheet included in the registration statement; or (b) for the period from April 1, 19X6, to June 25, 19X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in the total or per-share amounts of income before extraordinary items or of net income. On the basis of these inquiries and our reading of the minutes as described in 4, nothing came to our attention that caused us to believe that there was any such change or decrease, except in all instances for changes or decreases that the registration statement discloses have occurred or may occur and except as described in the following sentence. We have been informed by officials of the company that there continues to be a decrease in net current assets that is estimated to be approximately the same amount as set forth in 5*b* [or whatever other disclosure fits the circumstances].

Example N: Alternate Wording of the Letter for Companies That Are Permitted to Present Interim Earnings Data for a Twelve-Month Period

80. Certain types of companies are permitted to include earnings data for a twelve-month period to the date of the latest balance sheet furnished in lieu of earnings data for both the interim period between the end of the latest fiscal year and the date of the latest balance sheet and the corresponding period of the preceding fiscal year. The following would be substituted for the applicable part of paragraph 3 of example A.

3. . . . was to enable us to express our opinion on the financial statements as of December 31, 19X5, and for the year then ended, but not on the financial statements for any period included in part within that year. Therefore, we are unable to and do not express any opinion on the unaudited consolidated condensed balance sheet as of March 31, 19X6, and the related unaudited consolidated condensed statements of income, retained earnings, and cash flows for the twelve months then ended included in the registration statement

Example O: Letter to a Requesting Party on the Application of Specified Procedures in Conjunction With a Financing Transaction

81. This example assumes that these procedures are being performed at the lender's request on information included in an offering circular in connection with a private placement of notes with two

³⁸See footnote 30.

insurance companies. The letter is dated June 30, 19X6; procedures were performed through June 26, 19X6, the cutoff date.

June 30, 19X6

[Addressee]

Dear Sirs:

We have audited the consolidated balance sheets of The Blank Company, Inc. (the company) and subsidiaries as of December 31, 19X5 and 19X4, and the consolidated statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 19X5, included in the offering circular for \$30,000,000 of notes due June 30, 19Z6. Our reports with respect thereto are included in the offering circular. This offering circular, dated June 28, 19X6, is herein referred to as the "offering circular."

We have not audited any financial statements of the company as of any date or for any period subsequent to December 31, 19X5; although we have conducted an audit for the year ended December 31, 19X5, the purpose (and therefore the scope) of the audit was to enable us to express our opinion on the consolidated financial statements as of December 31, 19X5, and for the year then ended, but not on the financial statements for any interim period within that year. Therefore, we are unable to and do not express any opinion on the unaudited consolidated condensed statements of income, retained earnings, and cash flows for the three-month periods ended March 31, 19X6 and 19X5, included in the offering circular, or on the financial position, results of operations, or cash flows as of any date or for any period subsequent to December 31, 19X5.

For purposes of this letter:

1. We have read the 19X6 minutes of meetings of the stockholders, the board of directors, and [include other appropriate committees, if any] of The Blank Company, Inc. (the company) as set forth in the minute books at June 25, 19X6, officials of the company having advised us that the minutes of all such meetings³⁹ through that date were set forth therein; and we have carried out other procedures to June 25, 19X6 (our work did not extend to the period from June 26 to June 30, 19X6, inclusive), as follows:

- a. With respect to the three-month periods ended March 31, 19X6 and 19X5, we have—
 - (i) Read the unaudited condensed balance sheet as of March 31, 19X6, and unaudited condensed statements of income, retained earnings, and cash flows of the company for the three-month periods ended March 31, 19X6 and 19X5, included in the offering circular, and agreed the amounts contained therein with the company's general ledger as of March 31, 19X6 and 19X5, and for the three-month periods then ended.
 - (ii) Made inquiries of certain officials of the company who have responsibility for financial and accounting matters regarding whether those unaudited condensed financial statements are in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited financial statements included in the offering circular. Those officials stated that the unaudited condensed financial statements are in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited financial statements.
- b. With respect to the period from April 1, 19X6, to May 31, 19X6, we have—
 - (i) Read the unaudited financial statements of the company for April and May of both 19X5 and 19X6 (this financial information is incomplete in that it omits the statements of cash flows and other disclosures required by generally accepted accounting principles), furnished us by the company, and agreed the amounts contained therein to the company's general ledger. Officials of the company have advised us that no financial statements as of any date or for any period subsequent to May 31, 19X6, were available.
 - (ii) Made inquiries of certain officials of the company who have responsibility for financial and accounting matters regarding whether the unaudited financial statements referred to in b(i) are stated on a basis substantially consistent with that of the audited financial statements. Those officials referred to above stated that the audited financial statements referred to in b(i) above are stated on a basis substantially consistent with that of the audited financial statements.
- c. As mentioned in 1b, company officials have advised us that no financial statements as of any date or for any period subsequent to May 31, 19X6, are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after May 31, 19X6, have, of necessity, been even more limited than those with respect to the periods referred to in 1a and 1b. We have made inquiries of certain officials of the company who have responsibility for financial and accounting matters regarding whether (a) there was any change at June 25, 19X6, in the capital stock or long-term debt of the company or any decreases in net current assets or stockholders' equity as compared

³⁹See footnote 29.

with amounts shown on the March 31, 19X6 unaudited balance sheet, included in the offering circular, or (b) for the period from April 1, 19X6, to June 25, 19X6, there were any decreases, as compared with the corresponding period in the preceding year, in net sales or in the total or per-share amounts of income before extraordinary items or of net income.

Those officials referred to above stated that there were no such changes or decreases.

The foregoing procedures do not constitute an audit conducted in accordance with generally accepted auditing standards. Also, they would not necessarily reveal matters of significance with respect to the comments above, nor would they necessarily disclose changes in specified financial statement line items, inconsistencies in the application of generally accepted accounting principles, or other matters. Accordingly, we make no representations regarding the sufficiency of the foregoing procedures for your purposes.

2. At your request, we also performed the following agreed-upon procedures:

- a. Read the unaudited pro forma condensed balance sheet as of March 31, 19X6, and the unaudited pro forma condensed statements of income for the year ended December 31, 19X5, and the three-month period ended March 31, 19X6, included in the offering circular.
- b. Made inquiries of certain officials of the company and of XYZ Company (the company being acquired) who have responsibility for financial and accounting matters as to whether all significant assumptions regarding the business combination had been reflected in the pro forma adjustments. Those officials referred to above stated, in response to our inquiry, that all significant assumptions regarding the business combination had been reflected in the pro forma adjustments.
- c. Compared the historical financial information for the company included on page 20 in the offering circular with historical financial information for the company on page 12 and found them to be in agreement.

We also compared the financial information included on page 20 of the offering circular with the historical information for XYZ Company on page 13 and found them to be in agreement.

- d. Proved the arithmetic accuracy of the application of the pro forma adjustments to the historical amounts in the unaudited pro forma condensed financial statements.

Because the foregoing procedures are less in scope than an examination of pro forma financial information, the objective of which is the expression of an opinion on whether management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the business combination referred to above, whether the related pro forma adjustments give appropriate effect to those assumptions, and whether the pro forma column reflects the proper application of those adjustments to the historical financial statements, we are unable to and do not express such an opinion. The foregoing procedures would not necessarily reveal matters of significance with respect to the comments in this paragraph.

3. At your request, we also performed the following agreed-upon procedures:

- a. We read the forecasted balance sheet, statements of income, retained earnings, and cash flows as of December 31, 19X6, and for the year then ending, attached to the offering circular.
- b. We tested the mathematical accuracy of the forecast and noted no mathematical errors.

Because the procedures described above are less in scope than an examination of prospective financial statements in accordance with standards established by the American Institute of Certified Public Accountants, we do not express an opinion on whether the prospective financial statements are in conformity with AICPA presentation guidelines or on whether the underlying assumptions provide a reasonable basis for the forecast. Further, there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material.

4. At your request, we have read the following, set forth in the offering circular on the indicated pages.

<u>Item</u>	<u>Page</u>	<u>Description</u>
a	13	"History and Business—Sales and Marketing." The table following the first paragraph.
b	22	"Executive Compensation—19X5 Compensation." The dollar amounts shown in the table "Cash Compensation" and under the headings "Compensation Pursuant to Plans," "Stock Options," and "Other Compensation."
c	33	"Selected Financial Data." The amounts of net sales, income from continuing operations, income from continuing operations per common share, working capital, total assets, long-term obligations, redeemable preferred stock, and cash dividends declared per common share for each of the five years in the period ended December 31, 19X5.

5. Our audit of the consolidated financial statements for the periods referred to in the introductory paragraph of this letter comprised audit tests and procedures deemed necessary for the purpose of expressing an opinion on such financial statements taken as a whole. For none of the periods referred to herein nor any other period did we perform audit tests for the purpose of expressing an opinion on

individual balances of accounts or summaries of selected transactions such as those enumerated above, and, accordingly, we express no opinion thereon.

6. However, for purposes of this letter we have performed the following additional procedures, which were applied as indicated with respect to the items enumerated above.

*Item
in 4*

Procedures and Findings

- a. We compared the amounts of military sales, commercial sales, and total sales shown in the offering circular with the balances in the appropriate accounts in the company's general ledger for the respective fiscal years and for the unaudited interim periods and found them to be in agreement. We computed the approximate percentages of such amounts of military sales and commercial sales to total sales for the respective fiscal years and compared the computed percentages with the corresponding percentages appearing in the offering circular and found them to be in agreement.
- b. We compared the dollar amounts of cash compensation for each listed individual with the corresponding amounts shown by the individual employee records for the year 19X5 and found them to be in agreement. We compared the dollar amounts of aggregate executive officers' cash compensation with the corresponding amounts shown in an analysis prepared by the company and found them to be in agreement.
- c. We compared the amounts of net sales, income from continuing operations, income from continuing operations per common share, and cash dividends declared per common share for the years ended December 31, 19X5, 19X4, and 19X3, to the audited financial statements included in the offering circular and the amounts for the years ended December 31, 19X2 and 19X1, with the financial statements included in the company's annual reports to stockholders for 19X2 and 19X1 and found them to be in agreement.

We compared the amounts of working capital, total assets, long-term obligations, and redeemable preferred stock at December 31, 19X5 and 19X4, with the financial statements included in the offering circular and the amounts at December 31, 19X3, 19X2, and 19X1, with the corresponding amounts in the financial statements included in the company's annual reports to stockholders for 19X3, 19X2, and 19X1 and found them to be in agreement.

7. It should be understood that we make no representations regarding questions of legal interpretation or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraph; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages listed above as set forth in the offering circular. Further, we have addressed ourselves solely to the foregoing data and make no representations regarding the adequacy of disclosures or whether any material facts have been omitted.

8. These procedures should not be taken to supplant any additional inquiries or procedures that you would undertake in your consideration of the proposed transaction.

9. Had we performed additional procedures or had we audited the company's March 31, April 30, or May 31, 19X6 and 19X5 financial statements in accordance with generally accepted auditing standards, or had we examined the pro forma financial information or the forecast in accordance with standards established by the American Institute of Certified Public Accountants, other matters might have come to our attention that would have been reported to you.

10. In reaching the findings above, we have assumed that no information has come to your attention which, if disclosed to us, could have materially affected our findings.

11. This letter is solely for your information and to assist you in conducting and documenting your investigation of the affairs of the company in connection with the offering of the securities covered by the offering circular, and it is not to be used, circulated, quoted, or otherwise referred to for any other purpose.

12. We have no responsibility to update this letter for events and circumstances occurring after June 26, 19X6.⁴⁰

⁴⁰If the letter refers to a debt offering, the accountant should consider whether it would be appropriate to include in the letter the caveat mentioned in footnote 23.

APPENDIX

DIFFERENCES BETWEEN SAS NO. 49 AND THE PROPOSED REVISION

1. SAS No. 49 was issued in 1984, prior to issuance of the following Statements on Standards for Attestation Engagements: (a) *Attestation Standards*, (b) *Financial Forecasts and Projections*, and (c) *Reporting on Pro Forma Financial Information*.

Both the guidance and examples in SAS No. 49 have been revised to reflect the issuance of these standards.

2. SAS No. 49 provides guidance to accountants in providing letters to underwriters in securities offerings under the Securities Act of 1933 (the "Act"), but it does not specifically prohibit the accountant from providing comfort letters to other parties and in other circumstances. SAS No. 49 has therefore been revised as follows:

- New footnote 2 prohibits the accountant from providing any additional letters to the underwriters (in connection with the same transaction as the one to which the comfort letter relates) in which the accountant comments on items otherwise precluded by SAS No. 49, as amended.
- New paragraph 2 permits the accountant to provide comfort letters only to parties with a due diligence defense under section 11 of the Act.
- New paragraph 13 states that a comfort letter relating to an underwritten offering may be addressed to a requesting party other than a named underwriter only when a law firm issues a written opinion to the accountant stating that the requesting party has a due diligence defense under section 11 of the Act.

3. Footnote 14 of SAS No. 49 notes that the accountant should not include in a comfort letter any description of procedures, or any assurance based on those procedures, regarding a financial forecast.

The Board concluded that in view of *Financial Forecasts and Projections*, issued in 1985 subsequent to SAS No. 49, the accountant should be permitted to comment in a comfort letter on a forecast. New paragraph 21i requires the accountant, if he or she has not audited the most recent annual financial statements, to obtain knowledge of the entity's internal control structure as it relates to the preparation of annual financial statements in order to perform agreed-upon procedures on a forecast and report, in a comfort letter, on the results of those procedures. *Financial Forecasts and Projections* does not set a similar requirement for an accountant to perform agreed-upon procedures on a forecast and report on the results of those procedures.

New paragraph 21i also requires the accountant, in order to comment in a comfort letter on a forecast, to perform, at a minimum, the procedures required for a compilation of a forecast in appendix B of *Financial Forecasts and Projections*.

4. SAS No. 49 requires the accountant, if he or she has not audited the most recent annual financial statements, to obtain knowledge of the entity's internal control structure as it relates to the preparation of the annual financial statements in order to comment in a comfort letter on pro forma financial information. This requirement has been retained although *Attestation Standards* does not have the same requirement for an accountant to perform agreed-upon procedures and report findings with respect to a presentation of an assertion (for example, pro forma financial information).

5. The effect on the comfort letter of a qualified opinion on the financial statements is discussed in paragraphs 32–35 of SAS No. 49. The Board considered changes in reporting due to the issuance of SAS No. 58, *Reports on Audited Financial Statements*, and SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, and notes, in new paragraph 34, that when the accountant's report on the most recent annual financial statements is other than the standard report, the accountant should refer in the comfort letter to that fact and discuss the subject matter of the explanatory paragraph or qualification.

6. SAS No. 49, paragraph 15, notes that accountants may comment on compliance with published SEC rules and regulations only with respect to those rules and regulations applicable to financial statements and financial statement schedules. SAS No. 49 further states, in paragraph 45, that "except with respect to requirements for financial statements, the question of what constitutes appropriate information for compliance with the requirements of a particular item of the registration statement form (for example, whether particular employee benefits constitute executive compensation as defined by SEC regulations) is a matter of legal interpretation outside the competence of accountants."

The Board concluded that certain items of Regulation S-K provided sufficiently objective criteria to enable an accountant to provide negative assurance on conformity therewith. New paragraph 43 now permits the accountant to comment on the conformity of certain financial information with the disclosure requirements of Regulation S-K as long as the following conditions are met:

- a. The information is derived from the accounting records subject to the appropriate internal controls of the entity's accounting system or has been derived directly from such accounting records by analysis or computation.
- b. This information is capable of evaluation against reasonable criteria that have been established by the SEC.

New paragraph 43 then notes that the following disclosure requirements of Regulation S-K generally meet those conditions:

- Item 301, "Selected Financial Data"
- Item 302, "Supplementary Financial Information"
- Item 402, "Executive Compensation"
- Item 503(d), "Ratio of Earnings to Fixed Charges"

7. New paragraphs 49–61 present guidance on letters to a requesting party in conjunction with a financing transaction.

New paragraph 58a limits statements by accountants with respect to unaudited condensed interim financial information, capsule financial information, pro forma financial information, financial forecasts, and subsequent changes or decreases to procedures performed and findings obtained. The accountant should not provide negative assurance based on agreed-upon procedures with respect to those items.

8. New paragraphs 62–65 provide guidance on responding to requests for reports on matters relating to solvency. The guidance contains the same prohibitions contained in the interpretation of Statement on Standards for Attestation Engagements that is titled "Responding to Requests for Reports on Matters Relating to Solvency." However, the format of the letter to be given to a requesting party is changed because of the guidance on letters issued in connection with other financing transactions, which is included in this Statement (see example O).

9. This proposed Statement amends SAS No. 35, *Special Reports—Applying Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement*, to note that if the accountant is requested to perform an agreed-upon procedures engagement in connection with a financing transaction, as defined, he or she must follow the guidance in this proposed revision.

10. This proposed Statement amends Statements on Standards for Attestation Engagements *Attestation Standards* and *Financial Forecasts and Projections* to note that the practitioner must follow the guidance in this proposed revision when he or she is requested to perform agreed-upon procedures on an assertion or on a forecast and report on those procedures in (a) a letter to an underwriter in connection with a filing under the Act and (b) a letter to a party who does not have section 11 liability under the Act in connection with a financing transaction.

11. This proposed Statement deletes paragraph 20 of AICPA *Professional Standards*, AU section 504, "Association With Financial Statements," because the guidance in paragraphs 49–61 would cover requests from those parties previously covered by AU section 504, paragraph 20.

12. The following revisions have been made to the example letters in SAS No. 49:

- a. The examples have been rearranged to appear in descending order of occurrence.
- b. Example A has been revised. The Board concluded that since inquiry of management had been made, in 4(b)(ii), as to whether the unaudited interim financial information conforms substantially with the audited financial statements, it should be commented on in the comfort letter (see paragraph 5(b)(i)).
- c. Old example G, which referred to the "subject to" opinion, has been replaced with new example I, which refers to an audit report containing an explanatory paragraph.
- d. Revised examples F and G now provide examples of negative assurance on conformity with certain disclosure requirements of Regulation S-K.

- e.* New example H illustrates an alternate form of describing procedures and findings regarding tables, statistics, and other financial information. An attached registration statement identifies, with designated symbols, items to which procedures have been applied.
- f.* Old example L (now new example D) on pro forma financial information has been revised to comply with the guidance for agreed-upon procedures in the attestation standards.
- g.* New example E illustrates comments on a financial forecast.
- h.* New example O is an example of a letter to be issued to a requesting party in connection with a financing transaction.